S. HRG. 98-117

THE FEDERAL FINANCING BANK

HEARING

BEFORE THE

SUBCOMMITTEE ON FEDERAL CREDIT PROGRAMS

OF THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

NINETY-EIGHTH CONGRESS

FIRST SESSION

ON

THE FEDERAL FINANCING BANK, TO IMPROVE UNDERSTANDING OF THE BANK, ITS ORIGINS, FUNCTION AND VALUE TO THE TAXPAYER

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THE FEDERAL FINANCING BANK

TUESDAY, APRIL 5, 1983

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
SUBCOMMITTEE ON FEDERAL CREDIT PROGRAMS,
Washington, D.C.

The subcommittee met at 9:05 a.m., in room SD–538 of the Dirksen Senate Office Building, Senator Paul S. Trible, Jr. (chairman of the subcommittee) presiding.

Present: Senators Trible, Gorton, Hecht, and Proxmire.

Also present: Senator Moynihan and Congressman Gradison, Jr.

OPENING STATEMENT OF SENATOR TRIBLE

Senator TRIBLE. Good morning. The meeting of the Subcommittee on Federal Credit will come to order.

Congressman Gradison, why don't you come forward and join our colleague, Senator Gorton, at the table.

At the outset, I would like to welcome my two distinguished colleagues here today for these oversight hearings on the operations of the Federal Financing Bank.

At this point, I would like to make a brief statement.

The Federal Financing Bank or the FFB, as it is called, is an important but obscure part of the U.S. Treasury. Although it has purchased nearly $125 billion in assets since its origins in 1974, very few people understand why it was created, what it does, and how it can hold down the cost of Government operations and limit Federal tax burdens.

One of the purposes of this hearing is to improve understanding of the Bank, its origins, function, and value to the taxpayer. The Federal Financing Bank is an intermediary. It borrows its money from the U.S. Treasury, which borrows, in turn, from the public. It lends funds to Federal agencies and to borrowers whose debts have been guaranteed by other Government agencies.

Providing low-cost funds to support Federal credit activities is a vital function of the Bank, one which helps hold down the cost of Federal operations. So it is vitally important to preserve these economies. Unfortunately, much of the activity financed by the FFB is off budget, a result of certain laws and the FFB's own off-budget status. Since 1974, the Federal Financing Bank has financed at least $97 billion in off-budget spending. Each year many billions of Federal dollars are spent off budget and financed by the FFB without proper congressional scrutiny.

Because of this Federal Financing Bank related activity and other reasons, true Federal spending and true Federal deficits are typically much higher than the spending and deficits recorded in the unified budget and discussed in Congress and the media. For example, during 1981 alone, the Federal Financing Bank-financed activities removed $21 billion from reported Federal spending. And in 1982 and 1983, Federal spending and the Federal deficit were understated by $14 billion per year.

Hidden spending of this magnitude proposes a serious problem for Congress. It undermines congressional-controll of spending and impedes the setting of spending priorities. In my opinion, the off-budget aspect of FFB activities deserves the closest attention. Should all Federal outlays appear in the Federal budget and should all outlays by an agency be charged to the agency responsible for them? These are questions that need answers. Budgetary reform is necessary, if Congress is to control spending and improve oversight. It will be even more vital if Congress adopts a balanced budget amendment or other spending limitations. And without budget accounting reform, the Federal Financing Bank's value as a cost saver will be lost.

So a second purpose of this hearing is to explore how the budgetary treatment of FFB activities can be improved without compromising the FFB's vital cost-saving mission.

Another area deserving exploration is the Federal Financing Bank's role in the growth of Federal credit activities. The Bank finances a very large volume of Federal lending year, mostly off-budget. Is the FFB an active participant in the explosive growth of Federal credit or merely a passive innocent bystander? It is important to know the answer, because Federal credit activities rank among the fastest growing types of Federal involvement in our economy and in our lives.

For example, in the past 10 years, Federal participation in lending has jumped. In 1973, the Federal Government participated directly or indirectly in 13.2 percent of the lending in our economy. This year that share has risen to 21.4 percent. Over those 10 years, spanning the Federal Financing Bank's existence, outstanding Federal and federally assisted credit increased a staggering $524 billion, rising from $241 billion to $765 billion at the end of 1982.

During that period the Federal Financing Bank made loans and acquired $125 billion in assets. FFB provides funds for onbudget's direct loans. Federal activity in that area has increased from about $900 million per year, 10 years ago, to $9.1 billion last year, an increase in annual net lending of 911 percent. The Federal Financing Bank also finances off-budget direct loans. Federal off-budget direct loans were only $100 million in 1973 but have skyrocketed to $14.3 billion in 1982, an increase 14,200 percent.

I believe that weak budgetary controls on credit in general and on the Federal Financing Bank financed activities in particular have contributed to these alarming trends. We need to strengthen budget control, in order to restrain the voracious growth in Federal credit activities. To do that, we need to understand the FFB's actual operations better.

There are now two significant proposals to change the budgetary treatment of FFB activities and to preserve FFB's financing econo-

mies. One proposal has been made by the administration and repeats a Banking Committee proposal from last year. It would change the accounting treatment of certain Farmer's Home Administration activities. A second proposal has been made by Senators Proxmire and Gorton in S. 711, the Truth in Budgeting Act. My friend and former colleague, Representative Bill Gradison, has introduced a companion measure in the House of Representatives. The Proxmire-Gorton-Gradison bill would insure that all outlays financed by the FFB would appear in the Federal budget and would be charged to the appropriate Federal agency. This proposal aims to improve budget accounting and strengthen congressional control of Federal spending and lending, yet it would not impair the FFB's legitimate functions.

[The complete statement of Senator Trible follows:]

Opening Statement of Senator Paul S. Trible, Jr.

I would like to welcome our witnesses here today for these oversight hearings on the operations of the Federal Financing Bank.

The Federal Financing Bank--or FFB, as it is called--is an important, but obscure, part of the U.S. Treasury. Although it has purchased nearly $125 billion in assets since its origins in 1974, very few people understand why it was created, what it does, and how it can hold down the cost of government operations and limit federal tax burdens. One of the purposes of this hearing is to improve understanding of the Bank--its origins, function, and value to the taxpayer.

The Federal Financing Bank is an intermediary. It borrows its money from the U.S. Treasury which borrows, in turn, from the public. It lends funds to federal agencies and to borrowers whose debts have been guaranteed by other government agencies. Providing low-cost funds to support federal credit activities is a vital function of the Bank, one which helps hold down the cost of federal operations. So it is vitally important to preserve these economies.

Unfortunately, much of the activity financed by the FFB is off-budget--a result of certain laws and the FFB's own off-budget status. Since 1974, the FFB has financed at least $97 billion in off-budget spending. Each year, many billions of federal dollars are spent off-budget, and financed by the FFB, without proper Congressional scrutiny.

Because of this FFB related activity, and for other reasons, true federal spending and true federal deficits are typically much higher than the spending and deficits recorded in the unified budget, and discussed in Congress and the media.

For example, during 1981 alone, FFB financed activities removed $21 billion from reported federal spending. And in 1982 and 1983, federal spending and federal deficits were understated by $14 billion per year via the FFB.

Hidden spending of this magnitude poses a serious problem for Congress. It undermines Congressional control of spending, and impedes the setting of spending priorities. In my opinion, the "off budget" aspect of FFB activities deserves close attention.

Should all federal outlays appear in the federal budget, and should all outlays by an agency be charged to the agency responsible for them? These are questions that need answers.

Budgetary reform is necessary if Congress is to control spending, and improve oversight; it will be even more vital if Congress adopts a balanced budget amendment or other spending limitation. And without budget accounting reform, the FFB's value as a cost-saver will be lost.

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It is important to know the answer, because federal credit activities rank among the fastest growing types of federal involvement in our economy and in our lives.

For example, in the past 10 years, federal participation in lending has jumped. In 1973, the federal government participated--directly or indirectly--in 13.2% of the lending in our economy. This year, that share has risen to 21.4%.

Over those 10 years--spanning the FFB's existence--outstanding federal and federally-assisted credit increased a staggering $524 billion, rising from $241 billion to $765 billion at the end of 1982. During that period, FFB made loans and acquired $125 billion in assets.

FFB provides funds for on-budget direct loans. Federal activity in that area has increased from about $900 million per year ten years ago to $9.1 billion last year--an increase in annual net lending of 911%.

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I believe that weak budgetary controls on credit in general, and on FFB-financed activities in particular, have contributed to these alarming trends. We need to strengthen budget control in order to restrain the voracious growth in federal credit activities. To do that, we need to understand FFB's actual operations better.

There are now two significant proposals to change the budgetary treatment of FFB activities, and to preserve FFB's financing economies. One proposal has been made by the Administration, and repeats a Banking committee proposal from last year. It would change the accounting treatment of certain Farmers' Home Administration activities.

A second proposal has been made by Senators Proxmire and Gorton, in S711, the "Truth in Budgeting Act". Representative Bill Gradison has introduced a companion bill in the House.

The Proxmire-Gorton-Gradison bill would ensure that all outlays financed by the FFB would appear in the federal budget, and would be charged to the appropriate federal agency. This proposal aims to improve budget accounting and strengthen Congressional control of federal spending and lending, yet it would not impair the FFB's legitimate functions.

I have some questions about these proposals, and I hope the witnesses will address them.

Senator TRIBLE. I want to welcome Senator Gorton, a distinguished colleague and member of this committee and my former colleague and friend, Bill Gradison, here this morning.

We'd be happy to hear from you at this point.

Senator GORTON. Is he your former friend, too? [Laughter.]

Senator TRIBLE. Our friendship remains constant. Slade, why don't you start out.

STATEMENT OF SENATOR SLADE GORTON

Senator GORTON. Thank you, Mr. Chairman.

I have a few brief words to say, more on the order of a statement than formal testimony, arising out of my chairmanship of the task force on Federal Credit of the Budget Committee in the 97th Congress, which I would be delighted to submit to you. But first I would like to congratulate the Chairman for his decision to hold this hearing.

The Federal Financing Bank plays a vital role in financing the activities of the Federal Government, a role which is, unfortunately, not well understood by the general public. Perhaps this hearing will help remedy this lack of knowledge. The Federal Financing Bank deserves to be rescued from obscurity. The Bank has grown in the 9 years since its inception to become the largest bank in the world, holding over $125 billion in loans and making almost $25 billion in new loans each year.

The Bank was created for a good and valid reason, to save the taxpayers money. When viewed narrowly, it has certainly accomplished that purpose. There have been certain undesirable side effects from the operation of the Federal Financing Bank, however, which should be addressed by the Congress. I believe this hearing to be a good place to start to find a legislative solution. Some of these problems became evident to me during the 97th Congress, when I chaired a temporary task force in the Senate Budget Committee on Federal credit programs. We discovered that the main problem with the operation of the Federal Financing Bank was that the Bank's operations were excluded from the unified budget by law and thus escaped the same congressional scrutiny that other expenditures received.

At least partially as a consequence, Federal credit programs have grown twice as rapidly as Federal spending programs over the last 6 years.

About 95 percent of the growth in Federal credit programs occurring outside the unified budget and excluding Federal response to agencies, and nearly 40 percent of all Federal credit programs are financed through the Federal Financing Bank. While I am sure that most Federal credit programs serve valid purposes, I doubt that the Congress would have allowed credit programs to grow twice as rapidly as spending programs, had the same controls been imposed on both types of programs.

It is for this reason that I have joined with Senator Proxmire in introducing the bill to bring the Federal Financing Bank on budget. I understand that Congressman Gradison has introduced a similar bill in the House and will explain it in some detail. I trust

that the problems created by the Bank's off-budget status will be aired during this hearing, and I look forward to action by the subcommittee and by the full committee, of which I am a member.

Senator TRIBLE. Thank you. Congressman Gradison.

STATEMENT OF WILLIS D. GRADISON, JR., U.S. REPRESENTATIVE IN CONGRESS FROM THE STATE OF OHIO

Mr. GRADISON. Thank you, Mr. Chairman, for this opportunity to testify before your subcommittee on Federal credit programs.

We are all painfully aware that Federal Government credit demands have forced up interest rates. There are many reasons for this. One reason which can be corrected easily and should be corrected is that the Federal Financing Bank is off-budget. It is allowing Federal agencies to generate billions of dollars in off-budget loans with virtually no budget constraints.

The history of the FFB in the House of Representatives is quite enlightening. The House Ways and Means Committee, on which I serve, held hearings on the possibility of establishing a central Federal debt management bank in 1972 and 1973. Paul Volcker, then Under Secretary of the Treasury for Monetary Affairs, testified on behalf of the administration. He assured the Ways and Means Committee members that placing that Bank, the FFB, off-budget would not alter the budget constraints of any Federal agency in any way, and would capture the potential efficiencies for more centralized debt management, and on the understanding that Federal agencies could not use the FFB to increase their loan capabilities, the Ways and Means Committee reported out the FFB Act of 1973. That act created the Federal Financing Bank and placed it off-budget.

Soon after the Federal Financing Bank Act was enacted, it became apparent that outlays of certain agencies were expanding dramatically, directly because of the FFB's off-budget status. In 1977 and 1978, the chairman of the Ways and Means Oversight Committee, the Honorable Sam Gibbons of Florida, held hearings on a group of bills which would have put the FFB on-budget. The hearings were concluded with the decision not to do anything with the FFB at that time. Rather the subcommittee recommended waiting until the credit budget was developed further, then dealing with the FFB in that context.

Today, 5 years after the last Ways and Means FFB hearings, Federal agencies are still making massive outlays through the FFB mechanism. Since 1975, Federal agencies have made over $100 billion in unbudgeted outlays through the Bank, as you have already pointed out, Mr. Chairman. That is why I have introduced legislation to put the FFB on-budget, and why I am testifying before you today. In retrospect, I believe there was no need to wait to put the FFB on-budget, even in 1978. I think the committee was hesitant to take action, because we didn't fully understand what a credit budget would encompass or, consequently, how it would affect FFB loans.

Presumably, the committee felt a credit budget would take care of unbudgeted FFB loans and perhaps believed that putting the Federal Financing Bank on-budget would become unnecessary. But

there now appears to be a growing consensus that putting the FFB on-budget is complementary to a credit budget and, moreover, that it is a necessary next step, regardless of how far Congress proceeds in developing the credit budget.

The reason for this growing consensus is simple, a binding credit budget will force Congress to appropriate most new loans. However, such an appropriation process will not be of full value, because it will not require that the annually appropriate outlays be included in the budget aggregates and therefore reflected in the size of the deficit.

When appropriations don't affect the annual budget deficit, appropriations are more likely to be a rubber-stamp of authorization levels rather than being an exercise of allocating scarce resources among competing claims, which is what the budget process is supposed to be about.

As a member of the House Budget Committee, as well as the Ways and Means Committee, I am painfully aware of this distinction which exists in the decisionmaking process. Placing loan outlays on budget would make the appropriations process more meaningful, because the loan outlays, as well as other forms of spending, will make the reported deficit larger.

Therefore putting the FFB in the budget is necessary, because only then will the loans and finances appear in the deficit total and be budgeted properly.

Of course, the credit budget is a good idea, and I support it. But it may be that the strength of the credit budget is the centralization of information on Government loan activity that it would provide, rather than the requirement that credit be appropriated. Through a credit budget, Congress can examine Federal loans as a whole, which is a key step in bringing Federal credit under control.

To illustrate the importance of centralizing information on loans, we might look at the experience with the Federal Financing Bank. Besides decreasing the Government's interest and in processing costs, the establishment of the FFB set a precedent, by allowing Congress to review a large group of previously scattered Government loans as a single unit.

After many years of studying the FFB loans and learning of their significance, Congress, accordingly, should now provide for budgeting of these loans. Once we have a more firmly established credit budget, Congress will be able to scrutinize information on overall Federal credit, just as it has scrutinized FFB loans. Then, in time, Congress will likely demand that all loan outlays included in the credit budget be put in the unified budget.

Placing the FFB on budget would budget those loans Congress already has studied for some time and, in coordination with the credit budget, create a mechanism for eventually bringing all loan outlays on budget. Indeed, I believe that Congress long-term credit strategy should be to be budget outlays capitalized over time in competition with outlays made currently. Placing the FFB on budget is consistent and complementary with such a longrun strategy, and an appropriate next step in the short run.

To sum up, the FFB's existence is well-justified. It has increased Government debt management efficiency. However, thus far, this efficiency has been gained at the loss of budgetary control. Putting

the FFB on budget will maintain the advantages of FFB debt management, while increasing congressional control over outlays.

I look forward to further the action by this body regarding the FFB's budget status.

In addition, I've been working with the Treasury, seeking their advice on technical amendments to the original Proxmire-Gradison bill. And I will soon introduce a revised bill in the house which will incorporate the Treasury's recommendations and which, it is my understanding, will have the support of the Reagan administration.

Mr. Chairman, I want to thank you and the members of your subcommittee for your consideration of my views on this issue.

Senator TRIBLE. I want to thank my distinguished friend for being here today and applaud his leadership in this important matter.

May I say that it's my intention to work with you and Senators Proxmire, Gorton, and other members of this committee to advance this initiative in a very timely fashion.

Although normally I would call on my friend Senator Hecht at this point, let me turn to Senator Proxmire, who introduced this same measure in the Senate and hear from him at this point.

Senator Proxmire.

Senator PROXMIRE. Thank you very much, Chairman Trible.

OPENING STATEMENT OF SENATOR PROXMIRE

I want to congratulate you for holding these timely hearings. I appreciate it very, very much.

And I also want to congratulate Congressman Gradison for coming over from the House and testifying and making such an excellent statement.

There are probably not too many people who have even heard of the Federal Finaning Bank. It's a relatively obscure unit of the Treasury that operates outside the Federal budget. It has no tellers, no windows, no pillars. It's not even listed in the phone book. It has only 7 full-time employees, yet it holds over $125 billion in loans.

In just 9 years, it's become the largest bank in the United States. The Bank was formed in 1973 to provide cheaper financing for Federal credit programs. It does this by borrowing money from the Treasury and reloaning it at a rate slightly above the Treasury rate.

Why was the Bank put outside the budget? Treasury argued it should be off-budget so as not to affect the budgetary status of any Federal credit programs. Off-budget programs financed by the Bank would then remain off-budget. Likewise, on-budget programs financed through the Bank would continue on-budget.

Congress accepted the Treasury recommendations with virtually no discussion. The budgetary treatment of the Bank was consistent with the view that the Bank should merely be a neutral financing vehicle for Federal credit programs.

Congress did not expect the Bank would either encourage or discourage the growth of these programs. But despite these expectations, the Bank has been a key factor in the explosive growth of Federal credit programs.

By opening new opportunities for off-budget financing, it has become much more than a neutral financing vehicle. For example, a federally guaranteed loan can be converted into an off-budget direct loan simply by selling it to the Federal Financing Bank.

Likewise, a Federal agency can offset the entire cost of its loan program by selling loans to the Bank.

These features have made the Bank increasingly attractive to the managers of Federal credit programs.

If we exclude federally sponsored agencies, nearly 40 percent of all Federal credit programs are now financed through the Federal Financing Bank.

Over the last 5 years, the Bank's outstanding loans increased at an annual rate of 29 percent, or more than twice as fast as the increase in on-budget programs. The rapid growth of Federal credit programs has diverted an increasingly larger share of our national savings away from productive investment in the private economy.

Since 1977, Federal credit programs have absorbed 12 percent of the total amount of credit available in the economy. By 1982, Federal programs claimed 22 percent, almost twice as much.

If the deficit is included, the Federal Government claimed 49 percent of the total credit in 1982. In 1983, the percentage should exceed 75 percent.

So, it's no wonder interest rates remain so high.

Because of the explosive growth in the Federal credit programs, I believe the time has now come to put the operations of the Federal Financing Bank in the budget. I have introduced a bill to do this, along with Senator Gorton and Congressman Gradison.

I am hopeful the record of these hearings will demonstrate the need for this legislation.

There are two fundamental reasons why I believe the Federal Financing Bank should be in the budget:

First, excluding the Bank from the budget gives a false and inaccurate picture of the true size of the Federal Government and its budget deficit.

Second, the off-budget status of the Bank distorts the allocation of resources by allowing Federal credit programs to escape the discipline of the appropriations process.

Mr. Chairman, may I again congratulate you for holding these hearings. I look forward to hearing the testimony of the witnesses.

I want to thank Senator Hecht for so graciously permitting me to go ahead of him.

Senator TRIBLE. Thank you for your testimony and for your leading the charge on this issue for the last several years.

Senator Hecht.

Senator HECHT. Thank you very much, Mr. Chairman.

Your testimony suggests that putting the FFB-financed outlays on the Federal budget and charging them to the appropriate agency, as your bill does, will improve the appropriations process and make it more meaningful.

Would you explain that idea more fully, please.

Congressman GRADISON. Senator, as it is today, there simply is not the same scrutiny by the Budget Committee—at least the House Budget Committee, on which I serve—of the credit aspects

of an agency's budget that there is for the normal appropriation or entitlement aspects of an agency's budget.

We have been successful this year, as a result of a recommendation which I made, in having included in the report of the House Budget Committee to the full House a discussion of this subject and a breakdown of the Federal credit activities by function. This is a small step, but a step toward the kind of positive control over Federal credit activities which is encompassed in the bills which your committee is considering at this time.

Senator HECHT. One other question—the Federal Financing Bank is an intermediary. It borrows money and lends money. Presumably, these activities have different effects on interest rates. Yet, you indicated that having the FFB off-budget and allowing it to finance billions of dollars in off-budget loans and increase Federal credit demands would raise real and nominal interest rates.

How, exactly, does FFB-financed lending increase interest rates?

Congressman GRADISON. Senator, it's part of the general pressure which results from total Federal borrowing on a limited pool of savings in the economy.

The difficulty which we have today is not only the total amount of Federal borrowing, but the fact that part of it, in a sense, is hidden.

There is a certain lack of candor with the public and with the financial markets in the sense that the deficit—for example, the $189 billion figure which was incorporated in the President's budget proposals for fiscal 1984—and I'm sure is in the minds of many of us as the prospective deficit for 1984—understates the true amount of borrowing which would be required to carry out the programs included in the 1984 budget by the amount which is off-budget through these credit programs. It's not all FFB, but the FFB is the bulk of it.

So, one of the advantages, quite apart from the matter of greater control by Congress over borrowing, is that we would be leveling with the public and with the financial markets about the extent to which Federal activities require borrowing and thereby tend to push up interest rates if all of these items were included within some type of budgetary framework.

Senator HECHT. Thank you very much.

No further questions.

Senator TRIBLE. Thank you, Senator Hecht.

I would like to simply underscore a point that you made, Congressman Gradison.

As a former member of the House Budget Committee, I have sat where you now sit and wrestled with a Federal budget that's out of control. A point that must be made is that it's difficult, if not impossible, to establish rational budget priorities and fairly allocate our limited resources when so much of Government escapes the grasp of the Congress—indeed, our attention, let alone our grasp. That perhaps provides the most persuasive argument for insuring that these activities are reflected on budget.

Let me ask you this. As I understand your testimony, you suggest that the Federal Financing Bank outlays should be placed on-budget and allocated to the appropriate agency today or as soon as

possible, regardless of whether a Federal credit budget is developed or not?

Congressman GRADISON. That is correct.

I might say, Senator, that I think one of the reasons for our reluctance to face up to this issue—our reluctance not only within the Congress but probably within the administrations of recent years—is the awareness that following this recommendation it would make the deficit look larger. It would also make it more honest, as Senator Proxmire's bill indicates. I think we've got to recognize that this is an objection which has been raised.

It may well be that in order to accomplish this goal in a timely manner that it should be done by having a delayed effective date. Sometimes we move more quickly to do something along those lines and make it effective several years off than to keep putting it off indefinitely, as has been done in this case, because of a fear of being criticized for coming up with larger and larger deficits.

Senator TRIBLE. Perhaps it's a time for us to face the music and not put this off any longer.

I certainly agree with that. It will add a substantial amount to the deficit in the next fiscal year should this action be taken, but it will give a much more accurate picture of reality.

Congressman GRADISON. That's right, Senator.

I think that one of the urgent signs is that there is a growing attention being given to this issue. The Budget Committees are taking a look at it. The executive branch I know has been considering this seriously. It's been a subject of discussion at the Cabinet Council level, as I understand it.

The General Accounting Office and the CBO have also been examining this question, as has the Office of Management and Budget.

I have no idea where they will come out with the specific legislation. But on a matter of this kind—which is, frankly, sort of technical and doesn't attract a great deal of public or, for that matter, congressional interest—I think the growing attention being given by the organizations which I have just mentioned, who are highly respected for their professionalism and for their concern about the budgeting process of the Government itself, suggests to me that we may have a basis for congressional action.

Senator TRIBLE. I want to thank you again, Bill, for being here today, and let me just add a personal word to the record. It was my pleasure to serve with you in the House for 6 years. You're a man of great ability, and in our economic deliberations through the years you've always added a word of reason and insight. I thank you for being here today and coming over to the other body to add your voice in support of this kind of an issue.

Senator PROXMIRE. I do want to add my praise to that of the chairman. It's especially good that you were the author in the House, since you are on the Ways and Means Committee.

As you know, the jurisdiction of this bill in the Senate is with the Banking Committee; in the House it's the Ways and Means Committee, not the corresponding Banking Committee in the House.

You've developed an excellent reputation as the expert on the bank over there and I'm sure you'll do a very fine job on this legislation.

Incidentally this legislation doesn't take effect until 1985. Can you tell us what the prospects are for support for this legislation in the House?

Congressman GRADISON. Certainly the action which your subcommittee is considering will help us over there to attract attention to this issue. I certainly have wanted, as I'm sure you have, to have a basis for broad support for this legislation, and frankly we have delayed so much in producing a bill in the House this session, until we have the views of the Treasury with the thought that our bill once introduced would incorporate whatever technical changes they happen to suggest.

Certainly your leadership over the years when not much attention was being paid to this issue has been encouraging to many of us in the other body who felt that action was long overdue.

I do see some encouraging signs that the Ways and Means Committee might be willing to take another look at this, and I would say very specifically that the record of the testimony which you are taking starting this morning would be extremely helpful to us in calling the attention of our committee to the necessity for prompt action on this issue.

Senator PROXMIRE. Thank you very much, Mr. Chairman.

Senator TRIBLE. It would be my hope as well that the action taken by this committee may well spur some movement on the other side.

Bill, we thank you again.

Congressman GRADISON. That would be uncharacteristic, Senator, but this may be a first.

Senator TRIBLE. Thank you very much. Next we'll hear from the Honorable Roger W. Mehle, Assistant Secretary for Domestic Finance of the Department of the Treasury.

Mr. Secretary, welcome.

STATEMENT OF ROGER W. MEHLE, ASSISTANT SECRETARY FOR DOMESTIC FINANCE, DEPARTMENT OF THE TREASURY

Mr. MEHLE. Mr. Chairman, it's a pleasure to be here with you today.

I have a certain sense of fittingness in my testimony here today, at least personally, because I suspect this may be my last testimony given as a member of the administration since I'm planning to leave office, and I reflected as I came up here this morning, that my first testimony when I came into the administration was on this subject.

A lot has happened in the last 2 years on this matter, I'm delighted to be able to come to hearings of this kind to see the movement and pace that the Federal Financing Bank has attracted, and I hope it will carry through to a fruitful conclusion.

Senator TRIBLE. Let me just say as you begin your testimony that your entire statement will be made part of the record.

We welcome you here today. I know that your appearance here today brings mixed emotions as you come to the end of your public

tenure. We of course wish you well as you go back into the private world.

I have read all 22 pages of your testimony. I think it's very thorough and well-stated presentation, and I would encourage you perhaps to summarize some of the parts but err on the side of being detailed in your presentation, because I think your testimony here today may well—will surely provide strength to the record, and the points that you've made in your statement I think need to be made for the sake of the record.

ADMINISTRATION'S VIEWS ON FFB'S ROLE

Mr. MEHLE. Mr. Chairman and members of the subcommittee, I do welcome this opportunity to present the administration's views on the Federal Financing Bank and its operations, the FFB's role in Federal credit activities and the budget treatment of FFB and the programs it finances.

As you suggested, I will present a brief oral summary of the written statement I've submitted for the record.

My written statement discusses 10 specific points you asked us to address in your letter of February 23rd. I'll be happy to elaborate in response to any questions you might have on those points. Before addressing the specific points, I would like to make a general statement of the administration's policy regarding FFB and the budget.

The administration has conducted an extensive review of FFB in the broader context of overall administration budget and credit program policies. That review led to the adoption of two important principles. First, the administration supports a consolidated cash budget; second, the administration has concluded that over time all Federal debt operations should be consolidated within the Treasury Department and the FFB. Thus, the budget should include all of the Government's cash outlays to the public, including outlays to the public by FFB; and all agencies should, over time, be required to finance fully guaranteed obligations through FFB rather than in the securities markets.

With regard to the first principle, FFB is a Federal agency, so transactions between FFB and other Federal agencies are intragovernmental transactions and thus should not affect the budget totals. But when an agency guarantees loans made by FFB to the public, those outlays should be included in total budget outlays. This budget principle would not be served by including FFB outlays, as such, in the budget totals, since most FFB outlays are to other Federal agencies rather than to the public.

The question is then not whether FFB should be included in the budget, but whether all Federal outlays should be included in the budget, and our answer to that question is yes.

The administration has also concluded that outlays incurred to finance programs using FFB should be charged to the user agencies, not FFB. The purpose of including all Federal outlays in the budget is to subject such outlays to the discipline of the budget appropriations process, and this discipline can only be effective when applied to the agencies authorized by Congress to make the commitments that later result in FFB outlays. Thus, agencies author-

ized to make or guarantee loans which are financed by FFB should include such proposed outlays in their budget requests in the normal budget appropriations process. FFB itself should not be duplicating this process by seeking approprations to finance loans for which Congress has already appropriated funds to another Federal agency.

With regard to the second principle adopted by the administration, any obligation which is issued, sold or guaranteed by a Federal agency and is backed by the full faith and credit of the United States clearly should be financed by FFB rather than in the securities markets. This principle was in fact a primary justification for the Federal Financing Bank Act of 1973, and is essential to the efficient management of Federal debt.

My written statement discusses this principle further. I will now summarize the other major points of my testimony.

FFB was established by the Federal Financing Bank Act of 1973 at the request of the Treasury Department to deal with severe debt management problems resulting from years of off-budget financing which had flooded the Government securities markets with a variety of Government-backed securities. The securities were financed outside the Treasury by various Federal agencies in the form of direct agency issues, sales of guaranteed loan assets, and guarantees of obligations of private borrowers. Although the securities were backed by the Government, they sold at relatively high interest rates and fees, they competed with Treasury securities, undermined Treasury debt management policies, created serious marketing problems, and placed Treasury in a position of being required to sanction or approve agency financings on terms which Treasury believed did not reflect the full value of the Government backing.

That proliferation of Government-backed securities was very costly to the Government, in part because of higher transactions costs and in part because the less liquid markets for the securities resulted in higher profits to investors and to investment bankers.

The FFB Act was essentially a debt management reform, not a budget reform. In that regard the FFB was authorized to purchase any obligation issued, sold or guaranteed by any Federal agency and thus to consolidate and reduce the costs of financing Federal programs. The FFB Act did not change, however, the budget treatment of the programs financed by the FFB.

While the FFB's primary function is debt management, FFB has served to facilitate the control of Federal credit programs. By consolidating the borrowing of various agencies, FFB has made the problem of unrestrained growth in Federal credit more visible and has underscored the need for more effective control.

The extraordinary growth of loan guarantee programs is attributable to the erroneous view that meeting growing constituent demands for Federal assistance could be accomplished without pain or cost through the provision of off-budget loan guarantees and agency sales of loan assets but with full recourse to the Federal Government.

These programs would have grown as much or possibly even more without FFB, because they would have been financed off-budget directly in the Government-guaranteed securities market, at a greater direct cost to the Government, as they were before the

FFB was established. The FFB has also served to bring to the attention of Congress the true nature and aggregate impact of these programs, and has led to many important investigations and studies including this hearing, which it is hoped will in turn result in greater restraints on the future growth of these programs.

BILL S. 711

I have been asked to comment specifically on S. 711, a bill which would require different budget treatment for FFB-financed programs than is now the case.

S. 711 would further the administration's broader goals to provide better controls over all spending programs, including those financed with guarantees, and would also minimize the cost to the Government of financing these programs. To do this we need to distinguish among three major issues: program control, budget treatment, and method of financing.

With regard to program control, the credit budget submitted to Congress by the administration provides for control over the level of loan guarantee commitments by the Budget and Appropriations Committees. Under this approach loan guarantee programs could continue to be excluded from budget outlays but are subject to essentially the same appropriations process that has been applied to direct loans which are included in the budget totals. Since there is no difference in substance between a direct loan and a guaranteed loan, guaranteed loans should be subject to the same scrutiny as direct loans. This is an important step forward, and I am pleased to note that this approach has been adopted in the congressional budget resolutions and appropriations acts. We have clearly achieved the consensus that all Federal programs, including guaranteed programs, should be subject to more effective controls through the appropriations process.

As to budget treatment, S. 711 would expand the coverage of the Federal budget to include the amount of financing provided by FFB in the outlays of each program agency. Certain types of guaranteed loans would be required to be financed by FFB, based on certain findings by the Secretary of the Treasury. Other guaranteed loans would be financed outside of FFB. The bill explicitly addresses the genesis of the problem of growth of credit programs by including agency programs in the budget rather than by limiting the resources available to the financing mechanism, the FFB, for these programs.

As to financing, the requirement that agency programs be financed by FFB, with the exceptions to be determined by the Secretary of the Treasury, would prevent agencies from financing in the private market as a means to avoid budget scrutiny. In this regard, the administration supports the provisions of S. 711, but with technical amendments to clarify the budget accounting and the scope of the Secretary of the Treasury's determinations.

Mr. Chairman, this concludes my oral statement. I'll be happy to respond to the subcommittee's questions.

[The complete statement follows:]

Prepared Statement of Hon. Roger W. Mehle, Assistant Secretary of the Treasury (Domestic Finance)

Mr. Chairman and Members of the Subcommittee:

I welcome this opportunity to present the Administration's views on Federal Financing Bank (FFB) operations, the FFB role in Federal credit activities, and the budget treatment of FFB and of the programs it finances. My prepared statement discusses briefly the ten specific points you asked us to address in your letter of February 23, but I will be happy to elaborate in response to any remaining questions you may have. Before addressing these specific points, I will make a general statement of the Administration's policy regarding FFB and the budget.

The Administration has conducted an extensive review of FFB in the broader context of overall Administration budget and credit program policies. That review led to the adoption of two important principles. First, the Administration supports a consolidated cash budget; and, second, the Administration

the Administration has concluded that, over time, all Federal debt operations should be consolidated within the Treasury Department and FFB. Thus, the budget should include all of the Government's cash outlays to the public, including outlays to the public by FFB; and all agencies should, over time, be required to finance fully guaranteed obligations through FFB rather than in the securities markets.

With regard to the first principle, FFB is a Federal agency, so transactions between FFB and other Federal agencies are intragovernmental transactions and thus should not affect the budget totals. But when an agency guarantees loans made by FFB to the public those outlays should be included in total budget outlays. This budget principle would not be served by including FFB outlays, as such, in the budget totals, since most FFB outlays are to other Federal agencies rather than to the public.

The question then is not whether FFB should be included in the budget but whether Federal outlays should be included in the budget, and our answer to this question is yes. To accomplish this it would be necessary to delete the requirement in section 11(c) of the Federal Financing Bank Act of 1973 that FFB transactions not be included in the budget totals.

The Administration has also concluded that outlays incurred to finance programs of agencies using FFB must be charged to the user agencies, not to FFB. The purpose of including all Federal outlays in the budget totals is to subject such outlays to the discipline of the budget-appropriations process. This discipline can only be effective when applied

to the agencies authorized by Congress to make the commitments that later result in Federal outlays. Thus, agencies authorized to make or guarantee loans which are financed by FFB should include such proposed outlays in their budget requests in the normal budget-appropriations process. FFB itself should not be duplicating this process by seeking appropriations to finance loans for which Congress has already appropriated funds to another Federal agency.

With regard to the second principle adopted by the Administration, any obligation which is issued, sold, or guaranteed by a Federal agency and is backed by the full faith and credit of the United States clearly should be financed by FFB rather than in the securities markets. This principle was, in fact, the primary justification for the Federal Financing Bank Act of 1973, and it is essential to the efficient management of the Federal debt. I will discuss this in detail as I now turn to the ten specific points you asked me to address.

1. Overview of FFB operations

FFB was established by the Federal Financing Bank Act of 1973, at the request of the Treasury, to deal with severe debt management problems resulting from years of off-budget financing which had flooded the Government securities market with a variety of Government-backed securities. These securities were financed outside the Treasury by various Federal agencies in the form

of direct agency issues, sales of loan assets, and guarantees of obligations of private borrowers. Although the securities were backed by the Government they sold at relatively high interest rates and fees, they competed with Treasury securities, undermined Treasury debt management policies, created serious marketing problems, and placed Treasury in a position of being required to sanction or approve agency financings on terms which Treasury believed did not reflect the full value of the Government backing. That proliferation of Government-backed securities was very costly to the Government, in part because of higher transaction costs and in part because the less competitive market for the securities resulted in higher profits to investors and investment bankers.

The FFB Act was essentially a debt management reform, not a budget reform. That is, the FFB was authorized to purchase any obligation issued, sold, or guaranteed by any Federal agency and thus to consolidate the financing of both budget and off-budget programs and reduce the costs of financing these programs. The FFB Act did not change, however, the budget treatment of the programs financed by the FFB.

FFB was a response to a need to control and rationalize financing of Federal programs, primarily credit assistance programs. This need arose from three basic trends: (1) the rapid growth of Federal credit assistance programs; (2) the shift from direct loans (on-budget) to Government guaranteed loans (off-budget); and (3) the shift from Government guaranteed loans financed by local lending institutions to Government guaranteed obligations financed directly in the securities markets. These

trends have continued and have contributed to the explosive growth of Federal guarantee programs which has occurred in recent years.

FFB net lending activity in FY 1982 totaled $17 billion including $14 billion of off-budget lending and $3 billion of loans to Federal agencies whose expenditures of funds borrowed from FFB are included in the budget. At the end of FY 1982, the FFB portfolio totaled $124 billion including $98 billion of loans to off-budget entities and $26 billion to on-budget programs. The table attached to my statement presents FFB holdings at the end of FY 1982.

2. FFB's operations as originally conceived, and their subsequent evolution

The 1973 Act authorized the FFB to borrow directly in the market or from the Treasury. The Act limited FFB market borrowings to $15 billion. FFB borrowings from Treasury were not specifically limited; but, since Treasury is required to borrow in the market in order to lend to the FFB and since Treasury borrowings are subject to the statutory public debt limit, FFB borrowings from Treasury are effectively subject to the overall public debt limit.

The FFB issued one security in the market, an 8-month bill on July 30, 1974. All subsequent FFB borrowings have been directly from the Treasury. The 1974 bill issue traded in the market at about 3/8 of one percent above Treasury issues of comparable maturity. Treasury then decided that the FFB should be financed

directly by the Treasury, to avoid the additional cost to the Government of FFB market financing and to minimize the market impact of Treasury/FFB financing.

As to FFB's lending activities, there is a misconception that FFB purchases of various guaranteed obligations were not intended by the FFB Act of 1973. Treasury made it clear in the legislative history of the FFB Act that FFB's primary purpose was to finance federally-guaranteed obligations, including agency sales of guaranteed loan assets, as well as to finance direct Federal agency borrowing. The FFB Act expressly authorizes such financing of guaranteed obligations, which has comprised, since the early days of FFB's operations, the preponderant share of FFB lending activity. The legislative history of the FFB Act shows that the recognized primary need for FFB was to deal with the then growing problem of the inefficiency of market financing of guaranteed obligations, including sales of guaranteed agency assets.

3. FFB role in financing "off-budget" government spending

To put FFB activity into perspective, it is useful to compare it with overall Federal Government financing requirements and the "off-budget" component of the total. The President's budget submitted in January provides for $307 billion of net Federal and federally-assisted borrowing from the public in FY 1984. This consists of $189 billion to finance budget programs, including $3 billion financed through FFB. The remaining $118 billion of Federal and federally-assisted borrowing to finance spending

outside the budget includes: (1) $10 billion of net borrowing to finance loan guarantee programs through FFB; (2) $4 billion of other off-budget Federal spending programs, largely the Strategic Petroleum Reserve and Postal Service; (3) $49 billion of net private borrowing to finance guaranteed obligations, such as GNMA mortgage-backed securities, which are financed in the securities market rather than through FFB; and (4) $55 billion of net market financing for the Government-sponsored agencies, such as the Federal National Mortgage Association, Federal Home Loan Mortgage Corporation, and Farm Credit System, whose obligations are not guaranteed by the Government. FFB thus accounts for only a small proportion (about 9 percent in FY 1984) of Federal and federally-assisted financing for spending outside the budget.

3a. FFB role in removing from budget outlays the amounts paid by the FFB to purchase Certificates of Beneficial Ownership collateralized by agency direct loans

FFB purchases loan assets in the form of Certificates of Benefical Ownership (CBOs) from two Federal agencies: (i) the Farmers Home Administration (Farmers Home), which accounts for over 40 percent of the FFB loan portfolio; and (ii) the Rural Electrification Administration (REA). These assets were sold directly in the market in the form of fully guaranteed CBOs prior to the existence of FFB. Since the Farmers Home and REA statutes provide for expenditure offsets in the event of asset sales, the budget treatment of those asset sales is no different if CBOs are sold to FFB or in the market. Yet there is an actual budget saving when assets are sold to FFB, because the FFB interest rate is lower than rates of interest that would be charged in the securities markets. In the Farmers Home and REA

programs, the law provides that certain eligible borrowers will pay a below-market rate of interest, such as 5 percent. The agency that sells assets typically pays out of its budget the difference between the low interest rate paid by the borrower and the higher FFB, or market, rate of interest. Financing through FFB narrows the interest differential payment.

FFB also purchases whole loans from the Public Health Service (PHS) under the Heath Maintenance Organization program, and those loans are fully guaranteed as to timely payment of principal and interest. The PHS transaction with FFB, which is also treated as an expenditure offset in the budget, results in a higher price paid to PHS for its loans than would be the case if those assets were sold in the private market.

3b. FFB role in transforming an agency's loan guarantee into a direct, FFB-financed loan off-budget

While the myth seems to persist that guaranteed loans are substantially different from direct loans and involve less Government intervention in traditional borrower-lender relationships, this is not so. For both direct and guaranteed loans, the Government assumes the credit risk and private investors are the ultimate lenders. Direct loans are financed by Treasury issues of U.S. obligations to the same private investor groups that acquire U.S. guaranteed obligations. Therefore, every dollar of Government guaranteed debt financed in the public marketplace is like Treasury borrowing to finance direct loans and has a similarly adverse impact on private sector rates.

Most loan guarantee programs are financed directly in the private credit markets, and most of such financings are not controlled by the Treasury. Of the $59 billion estimated net increase in guaranteed loans in FY 1984, programs financed by FFB will account for $10 billion; GNMA mortgage-backed securities account for $31 billion; FHA and VA whole mortgages are about $14 billion; and the remaining $4 billion net guarantees are for smaller programs such as HUD public housing, Export-Import Bank export financing and MarAd ship construction.

A guaranteed loan may be termed a direct Government loan when FFB provides the financing but this characterization only obscures the underlying issue. FFB does not increase the amount of financing coming to market; it only accomplishes the task more efficiently. Nor does FFB financing of guarantees result in any increase in the Federal Government's contingent liability on these guarantees. In fact, the contingent liability is reduced since the guarantor agency will be liable for interest at a lesser rate than a private lender would charge, in the event of any default.

4. FFB's role in the expansion of Federal credit activities

While the FFB's primary function is debt management, FFB has served to facilitate the control of Federal credit programs. By consolidating the borrowing of various agencies, FFB has made the problem of unrestrained growth in Federal credit more visible and has underscored the need for more effective control. The extraordinary growth of loan guarantee programs is attributable to the erroneous view that meeting growing constituent demands for Federal assistance could be accomplished without pain or

cost through the provision of off-budget loan guarantees and agency sales of loan assets on a recourse basis. These programs would have grown as much or possibly even more without FFB, because they would have been financed off-budget directly in the Government-guaranteed securities market (at a greater direct cost to the Government), as they were before the FFB was established. Also, the FFB has served to bring to the attention of Congress the true nature and aggregate impact of these programs and has led to many important investigations and studies, including this hearing, which hopefully will in turn result in greater restraints on the future growth of these programs.

It should be recognized that a major stimulus to the growth of loan guarantee programs is the profit incentive of investment bankers and related private institutions to finance them in the market. FFB eliminates this incentive and, in this way, acts to curb the growth of guarantees. I know this to be an important factor from my own previous experience as an investment banker. Prior to the establishment of FFB, there was a very strong profit incentive for the investment banking industry to promote the growth of guarantee programs, and to take initiatives to establish new programs, since such guarantees would shift the financing from commercial banks to the securities market and provide new sources of income for investment banking services, such as financial advisory fees and underwriting profits. While investment bankers realize some profits from trading in

the Treasury securities issued to finance FFB, such profits are insignificant relative to the profit from marketing new issues of obligations guaranteed by other Federal agencies. Yet, to its credit, the investment banking industry testified in favor of the establishment of FFB in 1973, apparently recognizing that financial markets generally would benefit more if the Government got its financial house in order.

In fact, without FFB, the $17 billion of net FFB lending in fiscal year 1982 would have been financed by $17 billion of securities market financing by Federal agencies using direct issues and various forms of guaranteed market issues, asset sales, loan poolings, lease financing, and other devices which the agencies used prior to the establishment of FFB. Such financing techniques are far more costly to the Government.

Nevertheless, FFB is sometimes a scapegoat for the Federal credit progran control problems which have arisen. It is a common misconception that the FFB, because of its off-budget status, is in itself a means to avoid budget control. The FFB was created strictly for the purpose of reducing the costs of Federal and federally-assisted borrowing from the public in a manner least disruptive of private financial markets and institutions. The FFB itself does not affect either the budget status or the authorized program level of the agencies using FFB. Within the Administration, the actual allocation of budget and credit resources to various agencies and programs is determined

through the budget process. Therefore, efforts to control off-budget credit programs should be focused on the programs themselves, rather than on the FFB.

5. Current FFB lending practices, including the reasons for and desirability of the current policy of "accepting all comers" who are authorized to seek FFB financing of their activities

Under Section 6 of the FFB Act, FFB is authorized "to purchase and sell on terms and conditions determined by the Bank, any obligation which is issued, sold, or guaranteed by a Federal agency." To date, FFB has purchased only obligations that are direct obligations of a Federal agency or that are fully guaranteed by a Federal agency as to principal and interest. FFB's operating policy is to treat all borrowers on equal footing once the Federal guarantee is in place, unless there is a statutory directive to do otherwise. It should be noted, however, that FFB charges more than its standard spread over the interest rate at which FFB borrows from Treasury in instances where FFB is requested to purchase obligations that include unusual (for FFB) prepayment or other non-credit risks or loan servicing requirements.

FFB was established merely as a financing mechanism for programs that provide Federal credit assistance. The FFB practice of purchasing obligations from any eligible borrowers demonstrates FFB's neutrality in financing agency programs. If FFB were to differentiate among fully guaranteed borrowers, for example by denying access to FFB or by charging higher interest rates to some borrowers than to others, FFB would be in a position of allocating credit among programs that are authorized by the Congress and administered by other Federal agencies.

Currently, FFB's standard loan terms call for the FFB rate to be set at one-eighth of one percentage point above the prevailing Treasury market rate for obligations with similar payment terms and maturity dates. After deduction for relatively insignificant FFB administrative expenses, FFB's earnings are returned to the General Fund of the Treasury. In fact, FFB has returned $784 million of surpluses to the Treasury since it began operations in 1974.

Since the FFB rate is lower than rates that would be charged on similar guaranteed obligations financed in the private market, there has been concern that the interest cost saving afforded to Federal programs using FFB financing provides an additional and unwarranted incentive to borrow and may increase further the demands for expanded and new guarantee programs. Yet the bulk of the interest rate saving made possible by FFB financing is now captured by the Federal Government, in addition to the return of FFB surpluses mentioned above.

FFB purchases direct debt issues from Federal agencies as well as loans that these agencies have made to private borrowers. These activities constitute the bulk of FFB lending operations. If the agencies were required instead to sell their debt issues or loan assets directly in the private market, they would pay higher interest rates or realize lower sales prices which would add to budget outlays of the agencies and to total outlays in the President's budget. In most asset sales, the agencies make loans at below market rates and pay the difference between the loan rate and the FFB rate with appropriated funds.

FFB also makes loans under programs in which Federal agencies guarantee borrowings of non-Federal entities. Yet, even in this second group of beneficiaries of consolidated financing through FFB, much of the saving is realized by the Government, rather than by the guaranteed borrowers. An extreme case is the HUD guaranteed public housing program, where all of the saving goes to the Government, rather than to the guaranteed borrowers since all interest costs for public housing projects are borne by the Government. If, in cases where guaranteed loans financed by FFB actually reduce costs to private borrowers somewhat below the costs of guaranteed financing in the market, it is determined that this added interest rate saving should not be passed on to guaranteed borrowers, guarantee fees could be increased or other devices could be used to offset the benefit of FFB financing, rather than removing the program from FFB.

An alternative approach would be for FFB to raise the interest rate it charges its borrowers. Yet, as indicated above, in many programs this would require an increase in budget outlays by Federal agencies issuing, selling, or guaranteeing obligations purchased by FFB, while the interest rate charged the private borrowers whose loans are financed by FFB would not necessarily increase. In such cases, the net effect would be an increase in total budget outlays and, when the additional FFB profits are turned over to the Treasury, a corresponding increase in total budget receipts. Clearly, the better approach would be to require each agency using FFB to charge higher interest rates or fees to the private sector borrowers financed by FFB. In this way,

responsibility for program subsidies or costs would remain in the appropriate committees of Congress. Borrowers in Congressionally approved guarantee programs would be assured a source of financing at reasonable rates, and Treasury's debt management objectives would be met without FFB involvment in program decisions and duplication of the functions of the program agencies.

6. Reasons for and the desirability of leaving the FFB itself off-budget

Putting the FFB in the budget simply as an aggregate limit could place FFB in the position of allocating FFB credit among competing Federal programs. In the event that the FFB aggregate credit limit was not sufficient to meet all demands, agency program managers would revert to less efficient forms of financing. Pressures on program managers to reduce budget outlays would be irresistible and would be likely to lead to pressures for a mass exodus from the Bank into the credit markets. We would return to the chaotic market conditions of the early 1970's which led to the establishment of FFB. Today, Treasury and federally-assisted borrowing from the public combined is nearly seven times the 1973 dollar volume, a fact that emphasizes the critical importance of efficient Federal debt management.

A positive requirement that FFB transactions, as such, be included in the budget, as opposed to simple repeal of statutory language in the FFB Act that excludes FFB transactions from the budget, could override the normal budget accounting rules, under which transactions among Federal agencies are not reflected in budget totals. In that event, there would be double counting in the budget totals. Specifically, FFB loans to on-budget Federal

agencies would be counted twice in the budget, thus inducing such agencies to resume borrowing directly in the market. FFB purchases of obligations of off-budget agencies, assets sold by Federal agencies, and guarantees by Federal agencies, on the other hand, would be counted only once.

Accordingly, legislation to include in the budget any programs now financed off-budget by FFB should require that the budget outlays be attributed to the program agencies rather than to FFB.

7. The Administration's proposal to change the budgetary treatment of CBO sales by the Farmers Home Administration to the FFB

As I discussed earlier, current law provides that asset sales in the form of CBOs sold by Farmers Home and REA are to be treated as expenditure offsets rather than as a means of financing budget outlays. The CBO form of asset sale permits the selling agency to continue to hold and service the loans it originates, while at the same time to obtain funds for further loans. In another form of asset sale, the agency sells but continues to guarantee whole loans from its portfolio. Whole loan asset sales are conducted by the Public Health Service in sales to FFB and by GNMA and VA in sales to the market. These asset sales also are accorded budget treatment as negative outlays rather than as means of financing outlays, even though they are sold on a recourse basis and the Government remains liable to meet the obligations under the assets sold. This budget treatment is the same whether the assets are sold in the market or to FFB, and results in understatement

of expenditures and deficits in the Federal budget. In order to assure that the Federal budget more accurately reflects the total size of the Government's use of the Nation's economic resources, all agency direct lending activity should be counted in budget outlays. The proceeds of any asset sales should not be treated as expenditure offsets or negative outlays; sales in CBO form and in guaranteed whole loan form should be counted as a means of financing the deficit. Only sales of whole loans that are not guaranteed should be counted as receipts that would reduce the deficit.

8. FFB's views on the proposal by Senator Proxmire, embodied in S. 711 to change the budgetary treatment of certain Federal credit activities. Alternative ways to achieve the same goals which might be preferable.

S. 711 would further the Administration's broader goals to provide better controls over all guarantee programs and also minimize the costs to the Government of financing these programs. To do this we need to distinguish among three major issues: (1) program control, (2) budget treatment and (3) method of financing.

The "credit budget" submitted to Congress by the Administration provides for control over the level of loan guarantee commitments by the Budget and Appropriations Committees. Under this approach loan guarantee programs continue to be excluded from budget outlays, but are subject to essentially the same appropriations process that has been applied to direct loans which are included in the budget totals. Since there is no difference in substance between a direct loan and a guaranteed loan, guaranteed loans should be subject to the same scrutiny as direct loans. This is an important step forward, and I am pleased to note that this

approach has been adopted in the Congressional budget resolutions and appropriations Acts. We have clearly achieved a consensus that all Federal programs, including off-budget programs, should be subject to more effective controls through the appropriations process.

S. 711 would expand the coverage of the Federal budget to include the amount of financing provided by FFB in the outlays of each program. Certain types of guaranteed loans would be required to be financed by FFB, based on certain findings by the Secretary of the Treasury. Other guaranteed loans would be financed outside of FFB. The bill explicitly addresses the genesis of the problem of growth of credit programs by including agency programs in the budget, rather than by limiting the resources available to the financing mechanism, the FFB, for those programs. The requirement that agency programs be financed by FFB, with exceptions to be determined by the Secretary of the Treasury, would prevent agencies from financing in the private market as a means to avoid budget scrutiny. In this regard, Treasury supports the provisions of S. 711 but with technical amendments to clarify the budget accounting and the scope of the Secretary of the Treasury's determinations.

S. 711 recognizes that it is not feasible to prescribe by statute which obligations should be financed by FFB. Requiring all guaranteed obligations to be sold only to an on-budget FFB would clearly be inappropriate. For example, FFB should not be the initiator of small and administratively-cumbersome FHA and VA mortgages and guaranteed student loans, business that FFB was

not intended, nor is it now equipped, to undertake. A more limited requirement that FFB purchase market-type guaranteed securities issues, as suggested in S. 711, would be administratively feasible if the Secretary of the Treasury were provided sufficient discretion to determine which securities were appropriate investments for the FFB.

Section 3 of the FFB Act defines "guarantee" as "any guarantee, insurance, or other pledge with respect to the payment of all or part of the principal or interest on any obligation." This definition has been broadly interpreted to include a wide variety of obligations guaranteed or insured by Federal agencies, including obligations secured by Federal agency lease payments and obligations acquired directly by Federal agencies and sold to FFB subject to an agreement that the selling agency will assure repayment in the case of default of the non-Federal borrower. In addition, this definition has been interpreted to include guaranteed obligations which are supported by Federal agency commitments to make debt service grants, price support agreements, commitments to make a direct loan in the event of default on a private obligation, and other contractual arrangements which provide support equivalent to an outright guarantee. It is essential to preserve the broad definition of "guarantee", especially if guaranteed loans financed by FFB are to be included in the budget.

Effective Federal guarantees result when Federal agencies enter into contracts, rentals, leasing, billing, and other arrangements which are, in effect, pledged to secure in whole or in part the repayment of loans made by private lenders to project sponsors.

FFB should not purchase partially guaranteed securities. While existing law authorizes such purchases by FFB, and this flexibility is necessary to deal with situations where the guaranteed portion of a loan is financed separately, to date FFB has purchased only Federal agency obligations and obligations that are fully guaranteed as to principal and interest. By purchasing the non-guaranteed portions of partially guaranteed obligations, FFB would be forced to assess the creditworthiness of borrowers guaranteed by other Federal agencies and thus, would duplicate the functions of the guarantor agencies. Such purchases would also place the Government more at risk than was intended by Congress when it enacted provisions which limit guarantees to less than total principal and interest. We would be happy to work with your subcommittee to amend S. 711 to avoid these problems.

9. Pros and cons of direct limits on either FFB's direct lending and borrowing activities each year, or on the total FFB debt outstanding

Limitations on Federal agencies' direct spending and borrowing and on authorizations to guarantee loans in Congressional budget resolutions and appropriations Acts are the most effective means to control Federal credit programs. With regard specifically to FFB, all FFB borrowing is done through the Secretary of the Treasury, and, as you know, Treasury debt is subject to the statutory debt limit under the Second Liberty Bond Act. Thus when the Congress

reviews the need for increases in the debt limit, it has the opportunity to review FFB activity and financing requirements. Subjecting FFB to direct limits either on lending or borrowing without also limiting and setting priorities for entities that use FFB, would in effect put FFB in the position of allocating credit resources, a job that FFB could not appropriately perform. Furthermore, depending on restrictions placed on program agencies, an agency conceivably could finance a portion of its program in the market once the FFB limit was reached, thereby defeating FFB's purpose.

10. Suggestions, if any, to strengthen FFB's cost-saving functions

With regard to your tenth, and final, question, Mr. Chairman, FFB's cost-saving functions woud be strengthened by expanding FFB to include certain fully guaranteed obligations that are now financed directly in the securities markets. A Federal guarantee creates an instrument that is the credit-risk equivalent of a Treasury security. Yet guaranteed obligations are sold in the market at yield premiums over Treasury securities as a result of their relative trading illiquidity, smaller size of issues, and discrete terms that distinguish them from Treasury issues and each other. Recent market issues of securities fully guaranteed by the Maritime Administration, for example, have been priced at 1 to 1 1/2 points in yield above Treasury securities of comparable maturity. Also, tax exempt notes guaranteed by HUD are now financed in the market at a significant cost to the Government, both from the tax losses and the higher financing costs from

this less efficient marketing technique. Clearly, each of these programs could be financed at less cost through FFB. Since there is no economic difference between a guaranteed loan and a direct loan by FFB or another Federal agency, there is no reason to incur higher costs for financing guarantee programs in the private markets.

Mr. Chairman, this concludes my formal statement. I will be happy to respond to the Subcommittee's questions.

Attachment

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FEDERAL FINANCING BANK HOLDINGS
(in millions)

Program	September 30, 1982	Net Change 10/1/81-9/30/82
On-Budget Agency Debt		
Tennessee Valley Authority	$ 12,285.0	$ 1,411.0
Export-Import Bank	13,953.9	1,544.6
NCUA-Central Liquidity Facility	130.1	28.8
Off-Budget Agency Debt		
U.S. Postal Service	1,221.0	-67.0
U.S. Railway Association	194.9	-20.1
Agency Assets		
Farmers Home Administration	53,736.0	4,915.0
DHHS-Health Maintenance Org.	131.0	14.6
DHHS-Medical Facilities	145.7	-4.7
Overseas Private Investment Corp.	21.5	-5.1
Rural Electrification Admin.-CBO	3,123.7	528.4
Small Business Administration	58.1	-9.3
Government-Guaranteed Loans		
DOD-Foreign Military Sales	11,435.8	2,288.2
DEd.-Student Loan Marketing Assn.	5,000.0	700.0
DOE-Geothermal Loans	36.6	19.6
DOE-Hybrid Vehicles	-0-	-2.0
DOE-Non-Nuclear Act (Great Plains)	340.0	340.0
DHUD-Community Dev. Block Grant	117.0	42.7
DHUD-New Communities	33.5	-0-
DHUD-Public Housing Notes	1,624.3	695.8
General Services Administration	420.5	7.9
DOI-Guam Power Authority	36.0	-0-
DOI-Virgin Islands	29.5	-.4
NASA-Space Communications Co.	757.8	120.0
Rural Electrification Admin.	16,281.5	3,939.0
SBA-Small Business Investment Cos.	712.0	108.1
SBA-State/Local Development Cos.	48.4	43.2
TVA-Seven States Energy Corp.	1,258.0	343.8
DOT-Amtrak	855.4	75.5
DOT-Emergency Rail Svcs. Act	70.2	-0-
DOT-Title V, RRRR Act	122.8	-.8
DOT-WMATA	177.0	-0-
TOTALS*	$ 124,357.3	$ 17,057.0

*figures may not total due to rounding

Senator TRIBLE. Mr. Secretary, thank you very much. I had some questions, but at the outset let me just ask one and then yield to my colleagues for their questions.

DIRECT LOANS AND GUARANTEED LOANS DIFFERENT

In your statement you made, I think, an important point. Often when we're involved in great debates here in Congress the point is made that direct loans and loan guarantees are vastly different kind of transactions, but you've made the point, and the point is well taken, that really, to all intents and purposes, they're the same kind of economic transactions and they have the same kind of impact.

Mr. MEHLE. Absolutely.

Senator TRIBLE. Would you, for the sake of the record, discuss that for us and flesh out that observation so it can be better understood?

Mr. MEHLE. Yes, I will. A Government-guarantee program carries the credit of the United States Government. The purposes for which the guaranteed obligations are sold are, as a matter of fact, not really of interest in the securities marketplace. All the market participants and the ultimate investors care about is that the Federal Government is the ultimate obligor.

If that is the case, and it is the case, then there is no analysis of the underlying purposes for which the credit has been sought. There is no market discipline imposed on the borrowers under the guarantee program. The funds are basically obtained preemptively in the marketplace, much as the Treasury Department itself is able to obtain funds preemptively because it is the premier credit in the world. If that is recognized, then it logically follows that the Treasury Department could just as easily sell its own obligations and acquire credit preemptively, turn the proceeds over to the designated program beneficiaries, as loans to be sure, requiring them to pay principal and interest back on the loans which would be used to service the Treasury obligations sold to finance the lending. What actually happens of course is that Treasury is stepping aside but in fact is very much present because the mantle of its credit is making the program move forward. Its position as the intermediary merely is the role that is eliminated. It has steered the credit into the hands of the guaranteed obligor, and the repayment of the guaranteed loan simply moves directly into the hands of the party who lent the money without the Treasury Department touching it as it goes through.

As I say, only the agency, the instrumentality giving the funds to the beneficiary has changed, and that does not change the substance of the transaction.

Senator TRIBLE. Thank you, Mr. Secretary. Senator Hecht.

Senator HECHT. Mr. Secretary, is it your view that there would be an off-budget spending problem associated with certificates of beneficial ownership and loan guarantees even if the FFB were abolished?

Mr. MEHLE. Senator Hecht, the present budget conventions provide that a U.S. Government-guaranteed loan obligation sold to whomever FFB or to an open market participant, does not give rise

to a budget scoring in the on-budget deficit. In fact, it does not give rise to a scoring in the off-budget deficit. If you like, it scores only in the off-budget deficit, and that is very remote indeed. And if it's difficult to comprehend those kinds of concepts in this committee, imagine the difficulty the public has in sorting out these matters.

CERTIFICATES OF BENEFICIAL OWNERSHIP

As far as certificates of beneficial ownership are concerned, they give rise to a negative outlay when they are sold by an agency. Consequently, they serve to offset the outlays that are made by the agency in respect of the loans which are transformed into the certificates of beneficial ownership and then sold.

While the certificate of beneficial ownership (CBO) which seems like it might simply be a sale of a loan and thus a transfer of the risk that the Government formerly had to the private party who buys the CBO, it is not. The Government guarantees to the holder of the CBO that payment will be made even if the loans underlying the CBO are not paid by the private party who borrowed the funds to begin with.

Now, that treatment takes place regardless of to whom the CBO is sold, whether it be to the Federal Financing Bank or in the open market. That simply illustrates further the point that the Federal Financing Bank presently does not affect the budget treatment of guarantee programs or CBO's.

FFB SHOULD BE PRESERVED

Senator HECHT. One more question. You obviously believe that the FFB should be preserved. Yet, you also admit that there seems to be a serious budget loophole due to the off-budget status of many of the activities financed by the FFB.

Is it your view that the appropriate course of action for Congress to take is to improve the budgetary treatment of FFB-financed activities but essentially leave the FFB alone?

Mr. MEHLE. My view is that the outlays made by Government agencies, direct outlays, and the outlays that are made, in effect, by Government agencies through loan guarantees or through outlays which are then offset by the sales of certificates of beneficial ownership should be captured in the budget deficit.

Furthermore, it is the administration's belief that all the financing that is done to fund these programs, which are, in essence, the same, no matter what they are called—they are spending programs, financed by the Government—should be centralized and done by the Treasury Department, which is the FFB, in fact.

Senator HECHT. Thank you.

No further questions, Mr. Chairman.

Senator TRIBLE. Senator Proxmire.

Senator PROXMIRE. Thank you, Mr. Chairman.

Mr. Mehle, it's a pleasure to have you come before us. You follow in the tradition of Roger Altman, I believe.

Mr. MEHLE. I was told that a qualification to take this job was to be named "Roger."

Senator PROXMIRE. I wonder who the next Roger, the dodger is going to be before us?

But I think you're well qualified, in addition to your name.

Let me ask you a question about the principles which you state so well on page 2.

FEDERAL DEBTS SHOULD BE CONSOLIDATED WITHIN TREASURY

You say, at the top of the page:

> Over time, all Federal debt operations should be consolidated within the Treasury Department. Thus, the budget should include all of the Federal cash outlays to the public, including outlays to the public by the Federal Financing Bank. And it should be required, over time, to finance fully guaranteed obligations through the FFB rather than the securities market.

Then, a little further down, you state the principle as follows:

> Another principle, the question is not whether FFB should be included in the budget but whether the Federal outlay should be included in the budget. And our answer to this question is yes.

Now, these are, of course, the two key principles embodied in the legislation which Senator Gorton and I have introduced.

I take it, then, that subject to certain technical changes—and they are important changes—but subject to those changes, the administration supports the legislation; is that right?

Mr. MEHLE. That's right, Senator.

Senator PROXMIRE. Thank you very much, Mr. Mehle. I appreciate it.

Thank you, Mr. Chairman.

Senator TRIBLE. Mr. Mehle, let me make a few additional points if I might.

You noted in your testimony that the administration endorses the principles that all outlays of the Federal Government should appear in the consolidated cash budget.

Is it accurate to say that is the position taken by the Cabinet Council on economic policy?

Mr. MEHLE. It has been taken by the administration, and the Cabinet Council process was used to examine this issue and to study it for a number of months. So, it is accurate to say it is an administration policy. The organ for its formation was the Cabinet Council on Economic Affairs.

Senator TRIBLE. Is it also the view of the Cabinet Council on economic administration and the administration that individual agencies should be charged for the activities which they originate and that, also, such activities be authorized by Congress?

Mr. MEHLE. Absolutely.

Senator TRIBLE. There are some people frustrated by the growth of Federal credit activities who have suggested that the Federal Financing Bank could control its own lending by simply turning some borrowers away from its loan window.

A reading of your testimony suggests that you believe it's not the appropriate role of the Federal Financing Bank to do that, but rather that it's the responsibility of Congress to control these programs directly.

Is that a fair statement?

Mr. MEHLE. That's right, Senator.

Senator TRIBLE. There's been some discussion in the Congress lately about removing the Export-Import Bank from the unified budget.

What's your view of that kind of activity?

It would certainly seem to run counter to our discussions today.

Would you oppose that action?

Mr. MEHLE. To the extent that any agency carries the full faith and credit of the United States in its obligations, it is part of the Government. Accordingly, any outlays it makes, in accordance with that principle, should be scored in the budget, together with all other outlays of other parts of Government.

FEDERAL FINANCING FUNCTION

Senator TRIBLE. The Federal Financing Bank does perform a very important function. You addressed that briefly in your very fine statement that will be part of the record.

But I'd like you to amplify that point, if you would, and explain how the Federal Financing Bank's function as a financial intermediary does save money for the Government and for the taxpayers.

Mr. MEHLE. Yes. The agency program outlays are financed through the Federal Financing Bank, with funds that the Treasury Department borrows by the sale of Treasury obligations. As I said earlier, there's no better credit than the credit of the U.S. Government, and there's no more liquid securities market than the market for Treasury obligations. Thus, the Treasury is able to gain the lowest-cost money.

If the Federal Government has determined that there is some set of parties who should receive funds for some specified program, then these funds should be raised in the economy by the Federal Government in the most efficient and the least costly fashion. The sale of obligations by other than the Treasury Department, including guaranteed obligations in the open marketplace, will require higher interest rates and thus will increase the cost to either the Government or the intended beneficiary, because of the inferiority of the other obligations compared to those of the U.S. Treasury Department.

Senator TRIBLE. Let me ask you one final question, Mr. Secretary.

What, in your view, could be done to strengthen the cost-savings mandate of the Federal Financing Bank?

You didn't tackle that question head on in your statement, although you made some observations in that regard.

For example, in your written statement, you referred to securities guaranteed by the Maritime Administration and tax-exempt notes guaranteed by HUD.

Should these kinds of activities be financed through the Federal Financing Bank?

S. 711 EXCELLENT RESPONSE

Mr. MEHLE. In answer to the question about what could be done to strengthen the Federal Financing Bank in its cost-saving role, S. 711 is an excellent response, as we propose that it be amended, in that it would require all full-faith-and-credit obliga-

tions of Government agencies to go to the Federal Financing Bank. It would cover those that are not in the Federal Financing Bank now, with some exceptions that the Secretary of the Treasury might make.

I believe that that is the very best thing that could be done to strengthen the FFB in its cost-saving role, because it will pass along to the Government or to the program recipient the benefits of the Treasury Department's lower financing costs.

Senator TRIBLE. Senator Hecht, do you have any further questions?

Senator HECHT. No.

Senator TRIBLE. Secretary Mehle, let me say you're an able and articulate spokesman for the administration, and we will miss you.

I'm glad we've had the opportunity to work together at least this long.

We wish you well.

Mr. MEHLE. Thank you, Mr. Chairman, very much.

Senator TRIBLE. The subcommittee at this point will recess briefly.

May I say, for those here today, we will expect to hear from Senator Moynihan at approximately 10:15, followed by Alice Rivlin, Director of the Congressional Budget Office. She will be followed, in turn, by Harry Havens, the Assistant Comptroller General for Program Evaluation of the General Accounting Office.

At this point, we'll take a brief recess until Senator Moynihan appears.

[Recess.]

Senator TRIBLE. The subcommittee will return to session.

We will welcome Alice Rivlin, Director of the Congressional Budget Office.

Let me say, Dr. Rivlin, I've benefited from your testimony often in the other body, as a Member of the Budget Committee. It's a special pleasure for me to welcome you here today, as a member of the Senate.

We have heard this morning from Senators Proxmire and Gorton and Congressman Gradison in regard to their legislation that would place on budget many or all of the activities of the Federal Financing Bank.

We've also heard from Roger Mehle, Assistant Secretary for Domestic Finance in the Treasury Department.

And soon Senator Moynihan will be joining us.

We thank you for your presence today.

Your testimony will be made part of the record. So, please feel free to summarize your testimony if you care to do so.

STATEMENT OF ALICE M. RIVLIN, DIRECTOR, CONGRESSIONAL BUDGET OFFICE

Ms. RIVLIN. Thank you, Mr. Chairman.

It's a special pleasure for me to be here today.

I'm delighted to talk about the Federal Financing Bank. I think most of the people who have thought about it have come to pretty much the same conclusion—namely, that the Federal Financing Bank does what it was intended to do very well. It lowers the inter-

est cost of agency borrowing. That is what it was supposed to do. But in the process, it has had some unintended effects on the budget that make it harder for the Congress to understand what is really going on. Those effects can be fixed by changing the budget treatment of the transactions with the FFB in various ways.

My testimony is not especially long. I'd be happy to read it if that would be all right with you.

FFB MEETS OBJECTIVE OF REDUCED INTEREST COSTS

Mr. Chairman, I am pleased to be here to appear before the committee to discuss the operations and budgetary implications of the Federal Financing Bank. The FFB has met the objective for which it was created—reducing the interest costs of Federal agencies that otherwise would have marketed their own debt.

But the budgetary treatment of the FFB has created two problems not foreseen at the Bank's inception, facilitation of the transfer of onbudget outlays to off-budget status, thereby understating unified budget deficits, and conversion of programs approved by the Congress as guaranteed loans into off-budget direct Government loans. Hence, the budgetary treatment of the FFB potentially distorts fiscal policy and the allocation of resources among programs.

The budgetary treatment of the FFB should be revised to conform more closely to the original intent of the Congress. This could be accomplished by modifying the budgetary treatment either of programs financed by the FFB or of the FFB itself. The adminstration has proposed a revision in the financing of the Rural Housing Insurance Fund. This approach could be broadened to revise the budgetary status of other programs financed by the FFB on a program-by-program basis. Senators Proxmire and Gorton introduced the Truth in Budgeting Act, S. 711, which takes another approach, a comprehensive reform of the budgetary treatment of the FFB. This bill would correct the problems presented by the current budgetary treatment of the FFB in a single piece of legislation.

Problems caused by the budgetary treatment of the FFB are described in detail in a January 1982 CBO study, which I believe you have. My statement this morning briefly summarizes how the FFB functions, describes problems created by the budgetary treatment of FFB transactions and some alternative solutions to these problems.

Since 1974, the FFB has become an important source of financing for loans directly issued or guaranteed by Federal agencies. The FFB portfolio has grown rapidly and steadily since its inception. Its outstanding holdings totaled $124.3 billion in 1982 and, assuming the continuation of current policy, would exceed $210 billion by 1988.

The FFB finances three categories of activities: purchasing loan assets—Certificates of Beneficial Ownership, or CBO's—from an agency, making direct loans to borrowers holding agency guarantees, and purchasing agency debt. The largest category is purchases of loan assets, which accounted for 46 percent of the FFB's total holdings at the end of fiscal year 1982. The FFB has become the primary buyer of loan assets sold by Federal agencies. In 1975, its

first full year of operation, the FFB purchased 63.8 percent of all loan assets offered for sale by Federal agencies. By 1982, the FFB's share had increased to 86 percent, or $12.6 billion of the $14.8 billion in assets offered for sale.

The Farmers Home Administration has been the principal seller of loan assets to the FFB. As seen in table 1, FFB holdings of Farmers Home CBO's totaled about $54 billion by the end of fiscal year 1982, or 96 percent of the Bank's loan asset holdings.

TABLE 1.—FFB OUTSTANDING HOLDINGS BY TYPE OF ACTIVITY, FISCAL YEARS 1980–1982

[In billions of dollars]

Outstanding holdings	1980	1981	1982
Loan assets:			
Agriculture Credit Insurance (FmHA)	[1] 37.9	22.4	23.4
Rural Housing Insurance (FmHA)		21.1	23.9
Rural Development Insurance (FmHA)		5.3	6.4
Rural Electrification Administration	1.9	2.6	3.1
Other	0.6	0.4	0.4
Subtotal	40.4	51.8	57.2
Direct loans to guaranteed borrowers:			
Foreign military sales	7.2	9.1	11.4
Rural Electrification Administration	8.4	12.3	16.3
Student Loan Marketing Association	2.3	4.3	5.0
Low-rent public housing	0.1	0.9	1.6
Rail programs	1.1	1.5	1.1
Small Business Administration	0.5	0.6	0.7
Seven States Energy Corporation	0.7	0.9	1.3
Other	1.2	1.5	1.9
Subtotal	21.5	31.1	39.3
Agency debt:			
Export-Import Bank	10.1	12.4	14.0
Tennessee Valley Authority	8.9	10.9	12.3
Postal Service	1.5	1.3	1.2
Other	0.6	0.3	0.3
Subtotal	21.1	24.9	27.8
Total	83.0	107.8	124.3

[1] Includes activities of the Rural Development Insurance Fund and Rural Housing Insurance Fund.

DIRECT LOANS TO GUARANTEED BORROWERS

The second largest category of FFB activity provides direct loans to guaranteed borrowers, which represents 32 percent of the bank's total holdings. Instead of raising the funds in the securities market, a borrower with a guarantee from a Federal agency may have the FFB purchase the entire security issue. Thus the FFB in effect makes a direct loan to that borrower. In terms of dollar volume, the two largest categories of borrowers have been rural electric cooperatives, under guarantees by the Rural Electrification Administration, and foreign countries purchasing U.S.-made military equipment, under guarantees by the Department of Defense. These two categories accounted for $28 billion of the FFB's direct loans outstanding at the end of 1982.

The remaining 22 percent of the FFB portfolio consists of holdings of agency debt. Since its inception in 1974, the FFB has been

the sole financing agent for nearly all the new issues of agency debt. At the close of fiscal year 1982, its holding of agency debt was about $28 billion. The main debt issues held are those of the Export-Import Bank and the Tennessee Valley Authority. In recent years, the U.S. Railway Association and the Postal Service have both redeemed some of their debt held by the FFB.

The Federal Financing Bank was intended to be a neutral financial intermediary, lowering the Government's interest costs, but not otherwise affecting the budget. The FFB authorization provided that the bank's activities should not affect the budgetary status of agencies selling obligations to the bank, and further provided that the receipts and disbursements of the bank should not be included in the unified budget. The on-budget activity levels of agencies were not expected to be affected by the establishment of the FFB. In fact, however, the budget treatment of loan asset sales and direct loans to guaranteed borrowers financed by the FFB has affected the unified budget. Under current practices, FFB operations contribute to a situation in which the unified budget deficit understates Federal borrowing requirements and otherwise identical loans appear to have different budgetary costs.

Special provisions of law require sales of CBO's by the Farmers Home Administration and the Rural Electrification Administration to be treated as sales of assets, rather than as borrowing by those agencies. The significance of these provisions is that asset sales are treated as negative outlays in the unified budget. Thus, when the Farmers Home Administration makes $1 million in loans, and uses that as collateral for selling $1 million in CBO's to the FFB, the net outlays for the Farmers Home Administration are zero in the unified budget.

Before the FFB's establishment, when the Farmers Home or the REA sold a CBO to a non-Federal investor, the special provisions of law governing the treatment of CBO sales also removed the lending activity from the budget. The creation of the FFB, however, made the understatement of direct lending and of unified budget outlays a direct result of Federal activity. Instead of these outlays being incurred by a non-Federal investor, they are incurred by an off-budget entity of the Federal Government itself. In the current budget documents, the lending activity is recorded as budget authority and outlays of off-budget federal entities.

REDUCED ON-BUDGET OUTLAYS

In 1982, the sale of CBO's to the FFB by the Farmers Home Administration reduced on-budget outlays by 70 percent for rural housing, 42 percent for agricultural credit, and 73 percent for rural development, as shown in table 2. The off-budget rural electric and telephone revolving fund shifted all of its direct loans to the FFB. Its $500 million lending activity for 1982 does not appear in the unified budget.

The budgetary treatment of loan asset sales introduces a lack of uniformity into the budget's consideration. The Farmers Home Administration budget, the Agriculture appropriation bill, and related budget functions are all understated in the unified budget. This un-

derstatement potentially affects the level of funding for these programs.

TABLE 2.—FFB OUTLAYS COMPARED TO AGENCY OUTLAYS, FISCAL YEARS 1980–82

[In billions of dollars]

Outlays	1980	1981	1982
Rural Housing Insurance:			
Department of Agriculture outlays	1.7	−0.1	1.2
FFB outlays	1.9	4.0	2.8
Total outlays	3.6	3.9	4.0
FFB as a percent of total	53	103	70
Agriculture Credit Insurance:			
Department of Agriculture outlays	0.5	−0.2	1.4
FFB outlays	4.0	5.8	1.0
Total outlays	4.5	5.2	2.4
FFB as a percent of total	89	112	42
Rural Development Insurance:			
Department of Agriculture outlays	0.2	0.3	0.4
FFB outlays	1.0	1.0	1.1
Total outlays	1.2	1.3	1.5
FFB as a percent of outlays	83	77	73
Rural Electrification Administration:			
Department of Agriculture outlays	(1)	(1)	(1)
FFB outlays	0.7	0.7	0.5
Total outlays	0.7	0.7	0.5
FFB as a percent of total	100	100	100

[1] Less than $50 million.

The FFB is authorized to lend directly to borrowers whose loan notes carry a full guarantee of repayment by a Federal agency.

The agencies make guarantee commitments to qualified borrowers and then sell the guaranteed notes to the FFB. The FFB disburses funds raised through the Treasury to the borrowers, thus converting loan guarantees authorized by the Congress into direct loans. The conversion of loan guarantees into direct loans bypasses the constraints established by the Budget Act. The Budget Act specifically excludes guaranteed loans from the definition of budget authority. Direct loans, in contrast, require budget authority and are included in the targets and ceilings enacted in the budget resolutions.

When guaranteed loans are converted to direct loans, agencies increase their direct lending without having to request additional budget authority. The largest are the REA, which effectively increased its direct loans from $1.1 billion authorized to $5.8 billion extended in 1982, and the foreign military sales credit programs, which increased direct loans from $0.4 billion to $3.5 billion in 1982. These direct loans are accounted for in the off-budget FFB, not in the onbudget agency of origination.

If financing by the FFB makes it easier for a higher loan level to be attained, it affects the allocation of the federal resources. The FFB financing also increases direct federal borrowing requirements and the gap between the unified budget deficit and the total federal borrowing.

The unified budget deficit—the difference between revenues and onbudget outlays—is featured in the President's budget, in the con-

gressional budget resolutions, and most discussions of fiscal policy. Yet, it is actually the total borrowing requirements of the Federal Government that determine the government's impact on financial markets. These total budget requirements include both onbudget and off-budget deficits. Unnecessary confusion is added to the budget debate by the fact that the unified budget deficit understates the Government's borrowing requirements.

Most of the off-budget deficit is accounted for by the transactions of the FFB. There are also outlays of the Postal Service, the Rural Telephone Bank, and the Strategic Petroleum Reserve. But they're small.

Table 3 shows how the off-budget accounts understate the total deficit from 1974 to 1988. Because of the FFB, the unified budget deficit understated total deficit spending by about ⅓ in 1979. Since that year, the unified budget deficit has grown so rapidly that it has outpaced the off-budget deficit. It would be easier to bring all spending onbudget now that off-budget spending is a relatively small portion of the total deficit.

TABLE 3.—UNDERSTATEMENT OF THE BUDGET DEFICIT, FISCAL YEARS 1974–88

[In billions of dollars]

Fiscal year	Unified budget deficit	FFB outlays	Other off-budget outlays [1]	Total Federal deficit	Unified budget deficit as a percent of total deficit
1974	4.7	0.1	1.3	6.1	77.0
1975	45.2	6.1	2.0	53.3	84.8
1976	66.4	6.1	1.2	73.7	90.0
Transition quarter	13.0	2.6	−0.9	14.7	88.4
1977	44.9	8.1	0.6	53.6	83.7
1978	48.8	10.7	−0.3	59.2	82.4
1979	27.7	13.3	−0.8	40.2	68.9
1980	59.6	14.4	−0.2	73.8	80.8
1981	57.9	21.0	.....	78.9	73.4
1982	110.6	14.2	3.1	127.9	86.5
1983	194.0	14.7	2.9	211.6	91.7
1984	200.0	12.9	4.7	217.6	91.9
1985	210.0	13.3	2.3	225.6	93.1
1986	226.0	13.0	1.7	240.7	93.9
1987	248.0	13.5	3.7	265.2	93.5
1988	268.0	14.2	1.8	284.0	94.4

[1] Includes outlays of the U.S. Postal Service, Rural Telephone Bank, Regional Rail program, and the Strategic Petroleum Reserve.
Note.—1983–88 data are CBO revised baseline estimates.

The final form of financial transaction engaged in by the FFB is its purchase of agency debt, such as notes issued by the Tennessee Valley Authority. In these cases, the agency's interest costs are lowered, the outlays that the agency makes are recorded in the agency's budget—not in the FFB's—and the full impact on Government borrowing needs is recorded in the unified budget. Since this activity of the FFB performs a useful service and causes no budget distortions, it should be allowed to continue, even if reforms are undertaken to curb other FFB activities.

POSSIBLE SOLUTIONS

Now, for solutions. The budgetary problems raised by the FFB are attributable to the budgetary treatment of the transactions it finances: CBO sales and direct loans to guaranteed borrowers. These problems can be solved by changing the budgetary treatment either of those transactions or of the FFB itself.

A simple requirement to put the FFB on budget would make the unified deficit a better indicator of Federal financing needs. But it would still leave the activity levels in the guaranteeing agencies understated and would not mandate the voting of budget authority for guaranteed loans that are converted into direct loans. Thus, unless the budgetary treatment of loan asset sales and direct loans from the FFB is addressed, distortion in the budget will persist.

Two proposals to resolve these problems are currently before the Congress: the Administration's proposal to reclassify the asset sales of the Rural Housing Insurance Fund, and the Truth in Budgeting Act.

The Administration has proposed to reclassify CBO sales on the Rural Housing Insurance Fund as agency debt transactions rather than asset sales. If enacted, all past and future transactions between the RHIF and the FFB would be treated as borrowing by the RHIF. Borrowing against CBO sales would be treated in the unified budget as a financing transaction, rather than as a receipt offset against outlays. Thus, loans made by the RHIF would be correctly recorded as onbudget outlays of the RHIF even if financed by the FFB. This proposal was made in the context of the Administration's proposal for a rural housing block grant that would reduce Federal loans for rural housing.

While the reclassification of CBO sales for the RHIF is consistent with good budget practices, the proposal deals with only part of the problem. Comparable changes could also be made, however, to the other Farmers Home Administration and to REA activities financed by CBO sales. Similarly, changes should be made in the authorizations for all guarantee programs that are converted into direct loans by the FFB. Amendments to all these authorizations would insure that all direct lending is included in the unified budget and is counted in the budgets of the agencies that originate the activities. The provision removing REA from the unified budget would have to be dropped. If these changes were enacted, the Congress could make better informed decisions on the allocation of public funds and the FFB's role as an efficient money raiser would be retained.

The drawback to this approach would be the difficulty of amending the affected authorizations.

TRUTH IN BUDGETING ACT

Senators Proxmire and Gorton have introduced legislation to correct the problems presented by the budgetary treatment of the FFB by amending the Federal Financing Bank Act itself. The Truth in Budgeting Act would require the transactions of the FFB to be reflected in the unified budget. The Federal budget would therefore more accurately reflect the fiscal operations of the Federal Government.

The bill would require the transactions of the FFB to be recorded in the originating agencies' budgets, thereby ensuring that all agency transactions would be taken into consideration as budget resources were allocated.

Budget authority would have to be appropriated for any agency-guaranteed loan that is financed by the FFB. By requiring that Federal agencies first offer their loans and securities to the FFB, the Truth in Budgeting Act would insure that agencies could not bypass the FFB and return to the securities market.

S. 711 would make the unified budget a more comprehensive measure of Federal borrowing requirements and remove impediments to the allocation of Federal resources. The requirement for all agencies to sell their obligations to the FFB would create a problem, however. Programs such as the mortgage-backed securities program of the Government National Mortgage Association—GNMA—could be required to finance their activities through the FFB, thereby eliminating an existing and apparently viable secondary market in Government-guaranteed mortgages. We suggest that this language be considered further with the affected agencies and financial market experts.

CONCLUSION

In conclusion, Mr. Chairman, the budgetary treatment of the FFB currently distorts the unified budget. Remedies are needed to make the unified budget more comprehensive and to improve the accountability of the budget by recording transactions in the appropriate places. Either a broadening of the Administration's proposal or enactment of the Truth in Budgeting Act would be a step in the right direction.

Before I close, Mr. Chairman, let me raise two related issues. Correcting the budgetary treatment of the FFB would improve the unified budget.

The unified budget, however, still understates both direct Federal loans—because it counts only net lending—and loan guarantees. To some extent, these shortcomings are addressed by the credit budget, which has been implemented on an experimental basis by the Budget Committees. Progress in further strengthening of the credit budget will still be necessary, even after the FFB is reformed.

Finally, neither the unified budget nor the credit budget fully describes the relative value of spending, lending, and guarantees. These are not the same.

I would hope that we could explore these issues further with this subcommittee.

Thank you, Mr. Chairman.

[The complete statement follows:]

STATEMENT OF ALICE M. RIVLIN, DIRECTOR, CONGRESSIONAL BUDGET OFFICE

Mr. Chairman, I am pleased to appear before this Committee to discuss the operations and the budgetary implications of the Federal Financing Bank (FFB). The FFB has met the objective for which it was created: reducing the interest costs of federal agencies that otherwise would have marketed their own debt. But the budgetary treatment of the FFB has created two problems not foreseen at the bank's inception: facilitation of the transfer of on-budget outlays to off-budget status--thereby understating unified budget deficits--and conversion of programs approved by the Congress as guaranteed loans into off-budget direct government loans. Hence, the budgetary treatment of the FFB potentially distorts fiscal policy and the allocation of resources among programs.

The budgetary treatment of the FFB should be revised to conform more closely to the original intent of the Congress. This could be accomplished by modifying the budgetary treatment either of programs financed by the FFB or of the FFB itself. The Administration has proposed a revision in the financing of the Rural Housing Insurance Fund. This approach could be broadened to revise the budgetary status of other programs financed by the FFB on a program-by-program basis. Senators Proxmire and Gorton have introduced the Truth in Budgeting Act (S. 711), which takes another approach—a comprehensive reform of the budgetary treatment of the FFB. This bill would correct the problems presented by the current budgetary treatment of the FFB in a single piece of legislation.

Problems caused by the budgetary treatment of the FFB are described in detail in a January 1982 CBO study, "The Federal Financing Bank and the Budgetary Treatment of Federal Credit Activities," which has been provided to the Committee as background information. My statement this morning briefly summarizes how the FFB functions, describes problems created by the budgetary treatment of some FFB transactions, and presents alternative solutions to those problems.

FEDERAL FINANCING BANK OPERATIONS

Since 1974 the FFB has become an important source of financing for loans directly issued or guaranteed by federal agencies. The FFB portfolio has grown rapidly and steadily since its inception. Its outstanding holdings totaled $124.3 billion in 1982 and, assuming the continuation of current policy, would exceed $210 billion by 1988.

The FFB finances three categories of activities: purchasing loan assets (certificates of beneficial ownership--CBOs) from agencies, making direct loans to borrowers holding agency guarantees, and purchasing agency debt. The largest category is purchases of loan assets, which accounted for 46 percent of the FFB's total holdings at the end of fiscal year 1982. The FFB has become the primary buyer of loan assets sold by federal agencies. In 1975, its first full year of operation, the FFB purchased 63.8 percent of all

loan assets offered for sale by federal agencies. By 1982 the FFB's share had increased to 86 percent, or $12.6 billion of the $14.8 billion of assets offered for sale. The Farmers Home Administration (FmHA) has been the principal seller of loan assets to the FFB. As seen in Table 1, FFB holdings of FmHA CBOs totaled $53.7 billion by the end of fiscal year 1982, or 94 percent of the bank's loan asset holdings.

The second largest category of FFB activity provides direct loans to guaranteed borrowers, which represents 32 percent of the bank's total holdings. Instead of raising funds in the securities market, a borrower with a guarantee from a federal agency may have the FFB purchase the entire security issue. Thus, the FFB, in effect, makes a direct loan to that borrower. In terms of dollar volume, the two largest categories of borrowers have been rural electric cooperatives, under guarantees by the Rural Electrification Administration, and foreign countries purchasing U.S.-made military equipment, under guarantees by the Department of Defense. These two categories accounted for $27.7 billion of the FFB direct loans outstanding at the end of 1982, or 70 percent of the total.

The remaining 22 percent of the FFB portfolio consists of holdings of agency debt. Since its inception in 1974, the FFB has been the sole financing agent for nearly all new issues of agency debt. At the close of fiscal year 1982, its holding of agency debt was $27.8 billion. The main debt

issues held are those of the Export-Import Bank and the Tennessee Valley Authority. In recent years, the U.S. Railway Association and the Postal Service have both redeemed some of their debt held by the FFB.

BUDGETARY TREATMENT OF FFB FINANCING

The Federal Financing Bank was intended to be a neutral financial intermediary, lowering the government's interest costs but not otherwise affecting the budget. The FFB authorization provided that the bank's activities should not affect the budgetary status of agencies selling obligations to the bank and further provided that the receipts and disbursements of the bank should not be included in the unified budget. The on-budget activity levels of agencies were not expected to be affected by the establishment of the FFB. In fact, however, the budget treatment of loan asset sales and direct loans to guaranteed borrowers financed by the FFB has affected the unified budget. Under current practices, FFB operations contribute to a situation in which the unified budget deficit understates federal borrowing requirements and otherwise identical loans appear to have different budgetary costs.

Loan Asset Sales Shift On-budget Outlays Off Budget

Special provisions of law require sales of certificates of beneficial owernship (CBOs) by the Farmers Home Administration (FmHA) and the

Rural Electrification Administration (REA) to be treated as sales of assets rather than as borrowing by these agencies. The significance of these provisions is that asset sales are treated as negative outlays in the unified budget. Thus, when the FmHA makes $1 million in loans, and uses them as collateral for selling $1 million in CBOs to the FFB, the net outlays for the FmHA are zero in the unified budget. 1/

Prior to the FFB's establishment, when the FmHA or REA sold a CBO to a nonfederal investor, the special provisions of law governing the treatment of CBO sales also removed the lending activity from the budget. The creation of the FFB, however, made the understatement of direct lending and of unified budget outlays a direct result of federal activity. Instead of the outlays being incurred by a nonfederal investor, they are incurred by an off-budget entity of the federal government itself. In current budget documents, the lending activity is recorded as budget authority and outlays of "off-budget federal entities."

In 1982 the sale of CBOs to the FFB by the FmHA reduced on-budget outlays by 70 percent for rural housing, 42 percent for agricultural credit,

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1. Other than CBOs, sales of loan assets to the public by federal agencies conveys ownership and servicing responsibility to the purchaser. When a CBO is sold to the FFB, however, the originating agency retains title and does the servicing. Thus the case can be made that the CBO form is simply a device to hide transactions.

and 73 percent for rural development (see Table 2). The off-budget Rural Electric and Telephone Revolving Fund shifted all of its direct loans to the FFB. Its $0.5 billion lending activity for 1982 does not appear in the unified budget.

The budgetary treatment of loan asset sales introduces a lack of uniformity into the budget's consideration. The Farmers Home Administration budget, the Agriculture appropriation bill, and related budget functions are all understated in the unified budget. This understatement potentially affects the funding level for these programs.

FFB Conversion of Guaranteed Loans to Direct Loans

The FFB is authorized to lend directly to borrowers whose loan notes carry a full guarantee of repayment by a federal agency. The agencies make guarantee commitments to qualified borrowers and then sell the guaranteed notes to the FFB. The FFB disburses funds raised through the Treasury to the borrowers, thus converting loan guarantees authorized by the Congress into direct loans. The conversion of loan guarantees into direct loans bypasses the constraints established by the Budget Act. The Budget Act specifically excludes guaranteed loans from the definition of budget authority. Direct loans, in contrast, require budget authority and are included in the targets and ceilings enacted in the budget resolutions.

When guaranteed loans are converted to direct loans agencies increase their direct lending without having to request additional budget authority. The largest are the REA, which effectively increased its direct loans from the $1.1 billion authorized to $5.8 billion extended in 1982, and the foreign military sales credit programs, which increased its direct loans from $0.4 billion to $3.5 billion in 1982. These direct loans are accounted for in the off-budget FFB, not in the on-budget agency of origination.

If financing by the FFB makes it easier for a higher loan level to be attained, it affects the allocation of the federal resources. FFB financing also increases direct federal borrowing requirements and the gap between the unified budget deficit and total federal borrowing.

Budget Deficit Understates Total Federal Borrowing

The unified budget deficit--the difference between revenues and on-budget outlays--is featured in the President's budget, the Congressional budget resolutions, and most discussions of fiscal policy. Yet, it is the total borrowing requirements of the federal government that determine the government's impact on financial markets. These total budget requirements include both on- and off-budget deficits. Unnecessary confusion is added to the budget debate by the fact that the unified deficit understates the government's borrowing requirements.

Most of the off-budget deficit is accounted for by the transactions of the FFB. (The off-budget deficit also includes the outlays of the U.S. Postal Service, the Rural Telephone Bank, and the Strategic Petroleum Reserve.) Table 3 shows how the off-budget accounts understate the total deficit from 1974 to 1988. Because of the FFB, the unified budget deficit understated total deficit spending by one-third in 1979. Since that year, the unified budget deficit has grown so rapidly that it has outpaced the off-budget deficit. It should be easier to bring all spending on-budget now that off-budget spending is a relatively small portion of the total deficit.

Purchases of Agency Debt Fulfill FFB's Intended Role

The final form of financial transaction engaged in by the FFB is its purchase of agency debt, such as notes issued by the Tennessee Valley Authority. In these cases, the agency's interest costs are lowered, the outlays that the agency makes are recorded in the agency's budget (not the FFB's), and the full impact on government borrowing needs is recorded in the unified budget. Since this activity of the FFB performs a useful service and causes no budget distortions, it should be allowed to continue even if reforms are undertaken to curb other FFB activities.

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POSSIBLE SOLUTIONS

The budgetary problems raised by the FFB are attributable to the budgetary treatment of the transactions it finances: CBO sales and direct loans to guaranteed borrowers. These problems can be solved by changing the budgetary treatment either of those transactions or of the FFB itself.

A simple requirement to put the FFB on budget would make the unified deficit a better indicator of federal financing needs. But it would still leave the activity levels in the guaranteeing agencies understated and would not mandate the voting of budget authority for guaranteed loans that are converted into direct loans. Thus, unless the budgetary treatment of loan asset sales and direct loans from the FFB is addressed, distortion in the budget will persist.

Two proposals to resolve these problems are currently before the Congress: the Administration's proposal to reclassify the asset sales of Rural Housing Insurance Fund and the Truth in Budgeting Act.

Reclassify RHIF Asset Sales

The Administration has proposed to reclassify CBO sales of the Rural Housing Insurance Fund (RHIF) as agency debt transactions rather than asset

sales. If enacted, all past and future transactions between the RHIF and the FFB would be treated as borrowing by the RHIF. Borrowing against CBO sales would be treated in the unified budget as a financing transaction rather than as a receipt offset against outlays. Thus loans made by the RHIF would be correctly recorded as on-budget outlays of the RHIF even if financed by the FFB. The RHIF proposal was made in the context of the Administration's proposal for a rural housing block grant that would reduce federal loans for rural housing.

While the reclassification of CBO sales for the RHIF is consistent with good budget practices, the proposal deals with only part of the problem. Comparable changes also could be made, however, to the other FmHA programs and to REA activity financed by CBO sales. Similarly, changes should be made in the authorizations for all guarantee programs that are converted into direct loans by the FFB. Amendments to all these authorizations would ensure that all direct lending is included in the unified budget and is counted in the budgets of the agencies that originate the activities. (The provision removing REA from the unified budget would have to be dropped.) If these changes were enacted, the Congress could make better informed decisions on the allocation of public funds and the FFB's role as an efficient money raiser would be retained. The drawback to this approach would be the difficulty of amending the affected authorizations.

Truth in Budgeting Act

Senators Proxmire and Gorton have introduced legislation to correct the problems presented by the budgetary treatment of the FFB by amending the Federal Financing Bank Act. The Truth in Budgeting Act (S. 711) would require the transactions of the FFB to be reflected in the unified budget. The federal budget would, therefore, more accurately reflect the fiscal operations of the federal government. The bill would require the transactions of the FFB to be recorded in the originating agencies' budgets, thereby ensuring that all agency transactions would be taken into consideration as budget resources were allocated. Budget authority would have to be appropriated for any agency-guaranteed loan that is financed by the FFB. By requiring that federal agencies first offer their loans and securities to the FFB, the Truth in Budgeting Act would ensure that agencies could not bypass the FFB and return to securities markets.

S. 711 would make the unified budget a more comprehensive measure of federal borrowing requirements and remove impediments to the allocation of federal resources. The requirement for all agencies to sell their obligations to the FFB could create a problem, however. Programs such as the mortgage-backed securities program of the Government National Mortgage Association (GNMA) could be required to finance their activities through the FFB, thereby eliminating an existing, and apparently viable,

secondary market in government-guaranteed mortgages. We suggest that this language be considered further with the affected agencies and financial market experts.

CONCLUSION

The budgetary treatment of the Federal Financing Bank currently distorts the unified budget in several respects. Remedies are needed to make the unified budget more comprehensive and to improve the accountability of the budget by recording transactions in the appropriate places. Either a broadening of the Administration's limited proposal for the RHIF or enactment of the Truth-in-Budgeting Act would be a step in the right direction.

In closing Mr. Chairman, I would like to raise two related issues. Correcting the budgetary treatment of the FFB will improve the unified budget. The unified budget, however, still understates both direct federal loans (because it counts only net lending) and loan guarantees. To some extent, these shortcomings are addressed by the credit budget which has been implemented on an experimental basis by the Budget Committees. Progress in further strengthening the enforcement of the credit budget will still be necessary even after the FFB is reformed. Finally, neither the unified budget nor the credit budget fully describes the relative value of spending, lending, and guarantees. I would hope that we could explore these issues further with this Subcommittee.

Senator TRIBLE. Ms. Rivlin, I thank you for your testimony here today.

FEDERAL CREDIT ACTIVITIES ON ECONOMY

I think it's appropriate that the last statement in your testimony is of central importance to these proceedings, is the impact of Federal credit activities on the economy.

You are probably in a better position than other witnesses to take a few minutes, if you will, for the sake of the record, and spell out how Federal credit activities affect the economy, the allocation of credit, perhaps, to activities for which there is a lower financial return than other activities, that are able to generate more wealth for the economy.

I'm giving you an opportunity to say anything that comes to your mind. But I want to spell out for the sake of the record the importance of the Federal credit activities.

You've touched on those, as they complicate the budget process.

But obviously, not arguing the merits of any particular program, how would you assess the impact of the Federal credit activities, generally, on the economy?

What thoughts or concerns might you have?

Ms. RIVLIN. Let me give you several thoughts. First, I wish we knew more about it. The information on exactly how the Federal Government affects credit markets is not as great as one would like, and the CBO, in the institutional sense now, has tried to improve that information. We held a conference on Federal credit activities 3 years ago, but we don't know as much as we should.

Several observations are relevant, however. One is that the impact of the Federal Government on credit markets is very large, very diverse, and operates in ways that the Congress may well have not intended.

There are direct lending activities of various sorts with various levels of subsidy that grew up over the years and have not been systematically reexamined to see whether this is what the Congress really wanted to do. Some of these have been mentioned this morning. The biggest growth in recent years has been in Federal guarantees of loans rather than in direct lending. This may, in part, be the result of the budget process itself. Once the budget process focused attention on outlays to the extent that it has both off-budget lending and guaranteeing of private obligations became a favorite method of aiding activities the Congress wanted to aid. I think it is now time to pull all of that back together and ask, "Is that really what the Congress wanted to do?"

Subsidies in loans through lower-than-market interest rates are often large, very different from program to program, and often not well-understood.

Senator TRIBLE. Thank you, ma'am. Senator Hecht.

Senator HECHT. Thank you very much, Mr. Chairman. If Senator Proxmire's bill is adopted, how much of the off-budget spending problem will remain, and how much will be solved? One other point to this. What program will remain off-budget?

Ms. RIVLIN. The majority of the off-budget spending would then appear on the budget, but some would remain off. In fiscal 1984,

$4.8 billion would remain off-budget, of which the Strategic Petroleum Reserve would account for $2.7 billion, the Postal Service for $1.9 billion, and the Rural Telephone Bank for $0.2 billion. The projections of those numbers show somewhat declining levels in future years, so that they would not represent a major item still remaining off-budget. But for neatness' sake and comprehensiveness' sake, it would seem to be sensible to get all of them together.

Senator HECHT. One last question, please. You mentioned the current budgetary treatment of loan is very confusing to the uninitiated. You said that otherwise identical loans appear to have different budgetary costs. Can you give us an example?

BUDGETARY TREATMENT OF FFB

Ms. RIVLIN. Yes. I think probably the best examples are some of the things that we talked about with reference to the budgetary treatment of the FFB. If an agency such as Farmers' Home is lending a given sum under its own program authorization and then sells the loan assets—the certificate of beneficial ownership—to the FFB, the budgetary costs of the transaction appears on the unified budget to be zero, whereas another agency doing the same thing would have its budgetary costs fully recorded in the budget. So that if you were making a choice between those two agencies with respect to the effect of their programs on the unified budget, you would get a very misleading picture of what's really going on.

Senator HECHT. No further questions, Mr. Chairman.

Senator TRIBLE. Thank you, Senator Hecht.

There are those that argue against this kind of initiative, because it would add substantially to the deficit. There is a political argument, I guess, to be made there, but it seems to me that that factor provides perhaps the most persuasive argument for taking this kind of action. You have to know the full extent of our problems before we can realize the opportunities that might exist to tackle the deficit and restrain somewhat the growth of Government spending and more rationally allocate our limited resources.

How would you address that objection?

BORROWING REQUIREMENTS

Ms. RIVLIN. I would fully agree with your last statement—it does seem to me that there is no point in kidding ourselves. The whole problem of Federal activities should be addressed, particularly the whole problem of the Government's borrowing requirements, which have a major impact on our financial markets. We are very worried now that those requirements are too high, but the problem is not lessened by pretending that the borrowing requirements are slightly lower than they really are, which is what the concentration on the unified deficit does. It seems to me that now, when we are really facing up to the problem of the budget deficits and their impact on the economy, is the moment to face the whole thing, to be really honest with ourselves about what is happening and to improve the accounting practices so that the Congress can more easily see what the borrowing requirements are.

At the moment, the unified budget deficit is so large that, if you are dealing with a $200 billion deficit anyway, the marginal impact

of adding in the off-budget agencies is relatively small. For that reason, quite seriously, this may be a good moment to do it.

Senator TRIBLE. I was struck by your testimony. For example, your testimony about the very severe understatement of Farmers' Home and REA spending caused by current accounting practices.

Is it fair to say, Ms. Rivlin, that those kinds of results will continue unless and until we take this kind of action?

Ms. RIVLIN. I think it will be harder for the Congress to decide how it wants to allocate resources until it gets everything on-budget. It would seem to me that this is a fine first step, but that it would really be helpful to go further in budget reform and be able to look at the budget in what seems to me to be a straightforward way, namely, here is your direct spending, here is your gross lending, here is your new lending, here are the new guarantees being extended. And then on the other side of the budget to see what are you taking in in taxes, what loans are being repaid, what guarantees have lapsed?

That seems to me the way one ought to think about the Federal budget. That would not be accomplished simply by putting the off-budget agencies back on, because you would simply be netting out loan repayments against direct loans. But that would seem to me to be the direction in which the Congress ought ultimately to move.

Senator TRIBLE. These actions would be complementary, however, and would work together to achieve the desired result?

Ms. RIVLIN. Right.

BUDGET NEUTRAL

Senator TRIBLE. Apropos that last statement about the allocation of resources, I was struck by the use of the term in your statement "budget neutral." "The FFB was created and intended to be budget neutral," but it seems to me that because of the budget treatment of loan asset sales and direct loan guarantee borrowers, that it hasn't worked out that way.

Ms. RIVLIN. That is absolutely right. It has not. I think the types of activities that have been the major activities of the FFB were probably not anticipated to grow that rapidly, and probably nobody thought about what they were doing to the neutrality of the budget.

Senator TRIBLE. In a broader sense, in terms of the overall economy, it seems that any displacement—talking about credit allocation by the Government, that any displacement in the market of creditworthy by noncreditworthy borrowers will tend to lower the average rate of return from the economy's investments. This, in turn, it seems, would adversely affect economic growth and wages, and our future.

Would you care to address that observation?

Ms. RIVLIN. I would agree with that, but over the years the Congress has decided that there were activities sufficiently worthy that it was worth channeling credit into those activities, even if a somewhat higher rate of return was available in some other activities. For example, over the years, the Federal Government has channeled more credit into housing, into lending to students, and into other kinds of activities. One can rationalize the worthy public pur-

pose of all of these activities, but it is worth asking whether we are paying a price, because you are quite right that whenever we distort the credit markets in this way, there is a risk of moving our limited funds from activities with a higher rate of return to activities with a lower rate of return.

Senator TRIBLE. You said in your statement that even on-budget lending understates Federal lending, because it is on a net basis. Can you explain that for the record? And let me ask one further question. How serious is the understatement caused?

Ms. RIVLIN. It is very serious. All revolving funds are treated in the fashion which says you take all your new loans and subtract out the loan repayments, and the only thing that shows in the budget is the net new lending. The net lending number may be small, it may be even negative, at a time when the agency in question is engaging in a lot of new lending activity. You can't see that new lending in the budget, however, because the fund is getting a lot of repayments from past activity.

That is not to say that is bad, but it would be more useful to the Congress, I think, to be able to see clearly what was happening and now much new activity was really being undertaken.

Senator TRIBLE. There are those here in Congress who are talking about removing the Export-Import Bank direct lending from the unified budget.

How would you react to that kind of proposal? It seems to run counter to our discussions here today.

Ms. RIVLIN. It does. I am a budgeteer. I think that everything ought to be on-budget and that you never do yourself a favor by hiding something off-budget. There may be an argument for taking the Export-Import Bank off on the grounds that it is more nearly a commercial activity than some other forms of lending that remain on-budget, but that doesn't strike me as a very cogent argument. It is a Government activity.

Senator TRIBLE. I am not surprised by your answer, but I welcome that response.

Senator Hecht, do you have further questions for Ms. Rivlin?

Senator HECHT. Just one, just to allude to the last answer. Since I am a freshman here, but since this has been on for a few years, you mentioned you are strictly an on-budget person.

Why have you not brought this up—or have you brought this up before?

Ms. RIVLIN. I think we have. I have a consistent record of always favoring keeping things on budget, opposing the creation of new off-budget entities. In the case of the Strategic Petroleum Reserve, for example, we thought that it was a good idea, but that it should have showed up in the budget. And we have consistently taken the position that the Export-Import Bank ought to be on-budget.

Senator HECHT. Thank you.

Senator TRIBLE. We thank you, Ms. Rivlin, for your testimony today and for your responses to our questions.

Ms. RIVLIN. Thank you, Mr. Chairman. If we can be of any further service, let us know.

Senator TRIBLE. Thank you very much.

19-929 O--83---6

At this time, I am advised that Senator Moynihan will not be able to testify this morning, so his prepared statement will be made a part of the record at this time.

[The complete statement follows:]

STATEMENT OF DANIEL PATRICK MOYNIHAN, U.S. SENATOR FROM THE STATE OF NEW YORK

Mr. Chairman, members of the subcommittee, it is a pleasure to be here.

Last year, I was a member of the Senate Budget Committee's Temporary Subcommittee on Federal Credit. This subcommittee was formed with the mandate to investigate and report on the budgetary effects of Federal credit activities. As part of that mandate, we recommended that the budgetary treatment of the Federal Financing Bank (FFB) be changed by attributing the budget authority and outlays resulting from its operations to the agency initiating the credit transaction. To date, no further action has resulted from this recommendation.

It is becoming increasingly clear that the FFB must be put on-budget if we are to accurately reflect its use of budget resources. Between 1983 and 1988, an estimated $101 billion (an average of $17 billion annually) in off-budget borrowing will occur through the operation of the Federal Financing Bank according to the Congressional Budget Office baseline projections. Yet, as the Senate Budget Committee begins its deliberations on the effects of the budget deficit on financial markets, this large off-budget component is not even considered.

The Federal Financing Bank began operations in May, 1974. It was designed to serve as a financial intermediary for the efficient financing of obligations, issued, sold or guaranteed by Federal agencies. Next week, I will propose a bill that leaves these functions of the FFB intact but changes its budgetary treatment. Under my proposal, budget authority and outlays resulting from the operations of the FFB, which are now scored off-budget, would be attributed on-budget to the Federal agencies initiating credit transactions.

The omission of FFB outlays from the deficit seriously misstates the Federal government's credit demands and the effect of the federal budget on the nation's financial markets. Loan guarantees and direct loans financed through the Federal Financing Bank have as strong a reallocative effect on the national economy as does the on-budget deficit.

A conservative estimate of growth in total funds raised in U.S. credit markets, based on CBO economic assumptions, suggests that off-budget borrowing requirements, arising from the operation of the Federal Financing Bank, will average about 7 percent of total treasury borrowing during the period 1983–1988. If this is combined with loan guarantees, fully 25 percent of the total amount of federal and federally assisted borrowing in U.S. credit markets will not be recognized in the budget process.

FEDERAL PARTICIPATION IN THE NATION'S FINANCIAL MARKETS

	1983	1984	1985	1986	1987	1988
Total funds raised in U.S. credit markets	$428	$448	$469	$489	$508	$528
Federal borrowing from the public (on-budget)	215	212	224	241	260	267
Off-budget borrowing (Direct loans made through the FFB)	17	15	16	19	17	17
Federally guaranteed borrowing	56	57	59	60	61	62
Federal participation rate (percent) [1]	67	63	64	65	67	66

[1] This analysis does not include the effects of government-sponsored enterprises, which are privately owned, federally charted organizations. Examples are the Federal National Mortgage Association (FNMA) and the Student Loan Marketing Association. These organizations are frequently included in an analysis of the financial market effects of Federal policies—yet they are not under direct Congressional or Presidential control. Inclusion of their borrowing increases the Federal participation rate by an average of 13 percent.

Placing the outlays of the Federal Financing Bank on-budget would be an important step in insuring that the operations of the FFB receive appropriate congressional consideration. This is critical as the Senate Budget Committee faces its mark-up on the First Budget Resolution for fiscal year 1984. In this process, the Senate will be considering some very difficult budgetary alternatives; yet the process is made even more difficult if there isn't an accurate accounting of the full use of budgetary resources.

The activities of the Federal Financing Bank have been poorly understood due to the technical complexity of its operations.

In the final analysis, the FFB generates Federal cash outlays by making direct loans—just like any other outlay for direct lending by any other on-budget agency. The confusion occurs because there are many intervening steps before the FFB makes its outlays. The FFB:

Converts congressionally mandated loan guarantee programs into off-budget direct loans; and

Converts on-budget loans made by on-budget agencies into off-budget outlays through the purchase of securities called certificates of beneficial ownership.

In the end, a Federal outlay is the same whether it is on-budget or off-budget. In the case of of FFB, outlays generate Treasury borrowing that is identical in its economic effects and financial characteristics to borrowing generated by on-budget outlays. The only difference is what we call it in the budgetary process.

Historically, the existence of an off-budget financing entity has served to spur the growth of programs that have access to it. Government-wide, programs financed off-budget grew 44 percent during the period 1974–1981 while on-budget programs grew only 13 percent during the same period. This is a strong indication that budget accounting treatment has an important effect on program growth.

In another example, the Federal Financing bank has distorted the net budget impact of many on-budget agencies. In 1981, $39.6 billion in gross loans were made on-budget and $31.5 billion in gross loans were made off-budget, largely through the FFB. Through skillful budgetary manipulation, the Government only reported $5.2 billion in net on-budget outlays resulting from close to $40 billion in gross lending! While a proporation of the on-budget difference between the gross and net figures is due to repayments and write-offs for default, most of the difference is due to the process of shifting on-budget direct loans off-budget through the FFB. In the same year, 1981, off-budget outlays were reported to be $20.9 billion, more than four times as large as the on-budget outlays reported for lending activity.

We cannot conduct a rational review of budget priorities when this type of budget manipulation confuses the true scope of the Government's activities. I urge this subcommittee to consider recommending that the FFB be placed on-budget.

Nominal growth rates of on-budget outlays, off-budget outlays and net credit guaranteed, in selected functions, 1974–81

	Percent
International Affairs (150):	
On-budget outlays	9.6
Off-budget outlays	NA
Net credit guaranteed	14.7
Energy (270):	
On-budget outlays	42.2
Off-budget outlays	37.0
Net credit guaranteed	NA
Agriculture (350):	
On-budget outlays	13.8
Off-budget outlays	NA
Net credit guaranteed	53.8
Commerce and Housing Credit (370):	
On-budget outlays	0
Off-budget outlays	26.1
Net credit guaranteed	37.7
Community and Regional Development (450):	
On-budget outlays	12.1
Off-budget outlays	40.9
Net credit guaranteed	33.2
Education, Training, Employment, and Social Services (500):	
On-budget outlays	13.8
Off-budget outlays	51.2
Net credit guaranteed	26.0
Veterans Benefits and Services (700):	
On-budget outlays	7.7
Off-budget outlays	0
Net credit guaranteed	1.7
All Others:	
On-budget outlays	13.4
Off-budget outlays	49.0
Net credit guaranteed	4.2

Total:	
On-budget outlays	13.2
Off-budget outlays	43.9
Net credit guaranteed	32.1

PROGRAMS WITH LARGEST OFF-BUDGET OUTLAYS BY FUNCTION, 1981 DATA

[Dollars in billions]

	1981 off-budget outlays	Program as a percent of off-budget outlays in function
International Affairs (150): Foreign military sales credit	$1.9	99
Energy (270):		
REA telephone revolving fund	4.6	94
TVA fund	0.2	5
Agriculture (350): Agriculture credit insurance fund	5.8	100
Commerce and Housing Credit (370):		
Rural housing insurance fund	4.0	95
SBA business loan and investment fund	0.1	3
Community and Regional Development (450):		
Rural telephone bank	0.1	10
Rural development insurance fund	1.0	87
Education, Training, Employment, and Social Services (500): Guarantees of SLMA obligations	2.0	100
All other:		
NASA research and development (250)	0.1	100
Grants to National Railroad Passenger Corporation (400)	0.3	100
Low rent public housing (600)	0.8	100

FEDERAL NEW LENDING AND NET LENDING

[Fiscal year 1981; in millions of dollars]

	Gross loans activity			Net lending		
	On-budget	Off-budget	Total	On-budget	Off-budget	Total
Foreign military sales	671	2,505	3,176	−130	1,945	1,815
Economic development and support	1,120	.....	1,120	678	.....	678
Agricultural credit insurance	9,035	6,815	15,850	−898	5,790	4,892
Rural housing insurance	5,906	6,045	11,951	−1,000	4,045	3,045
Rural development insurance	1,578	1,650	3,328	−50	1,025	975
CCC	5,861	.....	5,861	−920	.....	−920
Public Law 480	781	.....	781	544	.....	544
Ex-Im Bank	3,512	.....	3,512	2,037	.....	2,037
Low-rent public housing	2,196	822	3,018	90	810	900
Other HUD	3,668	45	3,713	2,010	34	2,044
Rural electrification:						
In REA	3	1,089	1,092	3	43	46
In FFB	.....	4,690	4,690	.....	4,601	4,601
Railroad programs	143	1,794	1,937	143	250	393
Veterans housing	742	.....	742	124	.....	124
SBA:						
Disaster loans	1,652	.....	1,652	1,100	.....	1,100
Other	789	165	954	349	119	468
TVA	102	3,624	3,726	99	237	336
Education loans	109	1,955	2,064	9	1,955	1,964
Other agencies	1,662	333	1,995	965	66	1,031
Total	39,630	31,532	71,162	5,153	20,920	26,073

Senator TRIBLE. Next we will hear from Mr. Harry Havens, Assistant Comptroller General for Program Evaluation of the General Accounting Office.

Mr. Havens, we welcome you here today. I have your testimony before me. I have read your testimony. We will be pleased to make it a part of the record at this time in its entirety. You are invited to give your entire statement or summarize it as you see fit.

STATEMENT OF HARRY S. HAVENS, ASSISTANT COMPTROLLER GENERAL FOR PROGRAM EVALUATION, GENERAL ACCOUNTING OFFICE

Mr. HAVENS. In the interests of time, Mr. Chairman, with your permission, I would read only a very brief summary of the rather lengthy full statement.

The Federal Financing Bank has been successful as an intermediary to coordinate and consolidate agencies' borrowing functions saving interest and administrative and underwriting costs. But the off-budget status of the FFB and the budgetary treatment of its purchases of certificates of beneficial ownership and of guaranteed loans have caused problems since the Bank was created. Its off-budget status also understates outlay and deficit totals, key points of control in the budget process. This caused the budget deficit to be understated by about $14 billion in fiscal year 1982.

The off-budget status of the FFB has also perpetuated the lack of visibility associated with the use of CBO's as well as other credit activities that are off-budget in their own right.

FFB SERVES AS CAPTIVE MARKET

Were the FFB onbudget, and asset sales and fully guaranteed loans still financed through it, they would be recorded as outlays in the budget totals. It is reasonable to assume, we believe, that the resulting visibility in an era of severe budgetary constraints, would have led to greater restraint in the growth of many credit programs now financed by the FFB.

The FFB serves as a captive market for the sale of securities such as asset sales, and in particular, CBO's which are used by the Farmers Home Administration to finance lending activities. Before the FFB was created, Farmers Home arranged separately for the origination, underwriting and marketing of its issues. The FFB was created to eliminate the expenses of this sort associated with a multiplicity of agency issues. So the financing channel provided by the FFB has certainly made it easier for Farmers Home to fund its lending operations. It is reasonable to assume that this increased ease of financing, together with reduced visibility, may have translated into a greater level of lending activity.

In addition, the deepened interest rate subsidies associated with FFB lending for guaranteed loan programs may have stimulated the demand for Federal credit. Though fully guaranteed loans funded by private lenders are risk-free, interest rates are still higher than the cost of Treasury borrowing because private borrowing costs are higher and because of tax considerations. We cannot say, however, whether the lower interest costs of FFB-purchased guaranteed loans has stimulated demand for these loans, since it would depend on whether their supply under various assumptions, is unconstrained.

Just recently, we initiated a review of FFB's effect on credit and debt management issues. Specifically, our review will concentrate on:

A. The extent to which present procedures for using the FFB encourage greater use of off-budget financing than would occur without it.

B. Whether it would be appropriate to take additional steps to assure that credit extended as a result of FFB financing conforms to reasonable credit management standards.

C. Debt management issues, including FFB's effect on the maturity structure and cost of Treasury debt.

D. Ways in which greater use of the FFB might be advantageous to the Government. We will be pleased to keep you advised of the progress of this review.

Now I would like to turn to some actions that have been recommended by GAO and steps that have been taken to solve FFB-related problems. In recent years there has been a growing awareness of the budgetary problems created by the FFB's financing of CBO's and guaranteed loans and by the off-budget status of several Federal activities. As a result, there have been proposals from various organizations and individuals to correct the problems. Some of these recommendations focus on the FFB; others concentrate on the transactions that have helped create the problems.

There is no simple solution to problems surrounding oversight and control of Federal credit programs, and a number of changes are needed. To be effective, the changes should:

First, improve the meaning and usefulness of Federal program information and the unified budget totals, including the surplus or deficit figures.

Second, they should improve the information, analyses, and procedures for oversight and allocation of resources for Federal credit programs.

Finally, they should preserve the effectiveness of the FFB's intermediary operations.

GAO has addressed many of the issues affecting Federal credit programs and has made a number of recommendations. I would like to summarize them.

First, we recommend that the FFB be included in the budget.

Second, we recommend that CBO's be treated as borrowing by the program agency rather than as a sale of assets.

Third, we recommend that loans made by the FFB and guaranteed by a program agency be treated as agency borrowing from the FFB, with the direct loans then included in the program agency's outlays.

Fourth, we recommend that the outlays of revolving funds be reported on a gross basis. For credit programs this would require showing both gross new lending and loan repayments.

Fifth, and finally, we have long held that systematic congressional review, oversight, and decisionmaking through the budget process is as important for credit programs as for any other activity. Thus, we have urged the Congress to formalize its credit budget procedures. We are pleased to note both the significant steps taken by the Congress along these lines over the last few years and the additional actions that are now under consideration.

VIEWS ON S. 2162 AND S. 711

You asked for our views on S. 2162, introduced during the last Congress, and S. 711, introduced recently. We formally commented on S. 2162 last year. This was a bill to include FFB amounts in the budget totals and to require that the sale of CBO's and direct loans be treated as borrowings rather than as sales of assets.

The objective of S. 711 is similar. Based on our prior work in these areas, we fully support the objectives of legislation such as these two bills.

We understand that the Cabinet Council on Economic Policy also supports changing the status of the FFB and its transactions. We believe this was covered in the Treasury testimony earlier, but we have not seen the details of those recommendations prior to seeing their statement this morning. So I am not really in a position to comment in detail.

In the fiscal year 1984 budget, the President proposed that CBO's sold by the Rural Housing Insurance Fund of the Farmers Home Administration be treated as agency debt beginning in 1984. This is a good beginning. However, we believe that further legislation is needed to change the treatment of the remaining CBO sales, of which the RHIF is only one piece.

The FFB has done a good job of being a financial go-between. However, there are problems of how FFB has been used to accomplish off-budget financing for a number of credit programs.

We believe the problems are not inherently caused by the FFB itself, but in the way credit transactions are treated in the budget.

At the same time, we recognize that, while the FFB is not the direct cause of these problems, its off-budget status has added to them.

We continue to believe that decisions to allocate resources among competing activities are most efficiently and effectively done when all program costs are disclosed in the budget and when control is exercised through the budget process.

We would be very pleased to work with you to achieve those objectives.

That summarizes the main points of my statement, Mr. Chairman. I will be happy to respond to any questions.

[Summarized and complete statements follow:]

UNITED STATES GENERAL ACCOUNTING OFFICE

WASHINGTON, D.C. 20548

FOR RELEASE ON DELIVERY
EXPECTED AT 9:00 A.M.
APRIL 5, 1983

STATEMENT OF

HARRY S. HAVENS

ASSISTANT COMPTROLLER GENERAL

BEFORE THE

SUBCOMMITTEE ON FEDERAL CREDIT PROGRAMS

COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

UNITED STATES SENATE

ON

THE FEDERAL FINANCING BANK

Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to discuss our views on the operations of and budgeting for the Federal Financing Bank (FFB) and congressional oversight and control of Federal credit programs.

The Federal Financing Bank began operations in 1974. By 1982, its portfolio had grown to about $124 billion, averaging $20 billion per year in recent years. In fiscal year 1981 its portfolio was larger than any of the top ten banks in the United States.

The FFB has been successful as a debt management and financing tool. It operates as an intermediary to coordinate and consolidate agency credit functions, saving interest and administrative and underwriting costs. But the off-budget status of the FFB and the budgetary treatment of its purchase of certi-

ficates of beneficial ownership and guaranteed loans have caused problems since the Bank was created. This off-budget status also understates outlay and deficit totals, key points of control in the budget process. Because of the off-budget treatment of FFB operations, the budget deficit was understated by $14.1 billion in fiscal year 1982.

Furthermore, the off-budget status of the FFB has perpetuated the lack of visibility associated with the use of CBOs as well as other credit activities that are off-budget in their own right. Were the FFB on-budget and asset sales or fully guaranted loans still financed through it, they would be recorded as outlays in the budget totals. It is reasonable to assume that the resulting visibility in an era of severe budgetary constraints would have led to greater restraint in the growth of many credit programs now financed by the FFB.

The FFB serves as a captive market for the sale of securities such as asset sales, and, in particular, CBOs which are used by the Farmers Home Administration to finance its lending activity. Before the FFB was created, Farmers Home arranged separately for the origination, underwriting and marketing of its issues. The FFB was created to eliminate expenses associated with a multiplicity of agency issues. So, the financing channel provided by the FFB has certainly made it easier for Farmer's Home to fund its lending operations. It is reasonable to assume that this increased ease of financing may have translated into greater level of lending activity.

In addition, the deepened interest rate subsidies associated with FFB lending for guaranteed loan programs may have stimulated the demand for Federal credit. Though fully guaranteed loans funded by private lenders are risk-free, interest rates are still higher than the cost of Treasury borrowing because private borrowing costs are higher and because of tax considerations. We can not say, however, whether the lower interest costs of FFB purchased guaranteed loans has stimulated demand for these loans since it would depend on whether their supply under the various programs is unconstrained.

Just recently we initiated a review of FFB's effect on credit and debt management issues. Specifically, our review will concentrate on

--the extent to which present procedures for using the FFB encourage greater use of off-budget financing than would occur without the FFB;

--whether it would be appropriate to take additional steps to assure that credit extended as a result of FFB financing conforms to reasonable credit management standards;

--debt management issues, including FFB's effect on the maturity structure and cost of Treasury debt; and

--ways in which greater use of the FFB would be advantageous to the Government.

Now I would like to address some actions that have been recommended by GAO and steps that have been taken to solve FFB related problems. In recent years, there has been a growing awareness of the budgetary problems created by the FFB's

financing of CBOs and guaranteed loans and by the off-budget status of several Federal activities. As a result, there have been proposals from various organizations and individuals to correct the problems. Some recommendations focus on the FFB; others concentrate on the transactions that help create the problems.

There is no simple solution to problems surrounding oversight and control of Federal credit programs, and a number of changes are needed. To be effective, the changes should

--improve the meaning and usefulness of Federal program information and the unified budget totals, including the surplus or deficit figures;

--improve the information, analyses, and procedures for oversight and allocation of resources for Federal credit programs; and

--preserve the effectiveness of the FFB's intermediary operations.

GAO has addressed many of the issues affecting Federal credit programs, and has made a number of recommendations.

--We recommend that the FFB be included in the budget.

--We recommend that CBOs be treated as borrowing by the program agency rather than as a sale of assets.

--We recommend that loans made by the FFB and guaranteed by a program agency be treated as agency borrowing from the FFB, with the direct loan then included in the program agency's outlays.

--We recommend that the outlays of revolving funds be reported on a gross basis. For credit programs, this would require showing both gross new lending and loan repayments.

--Finally, we have long held that systematic congressional review, oversight, and decisionmaking through the budget process is as important for credit programs as for any other activity. Thus we have urged the Congress to formalize its credit budget procedures. We are pleased to note both the significant steps taken by the Congress along these lines over the last few years and the additional actions that are now under consideration. You asked for our views on S. 2162, introduced during the last Congress, and S. 711 which was introduced recently. We formally commented on S. 2162, a bill to include FFB amounts in the budget's totals and to require that the sale of CBOs and direct loans be treated as borrowings rather than as sales of assets. The objective of S. 711 is similar. Based on our prior work in these areas, we fully support the objectives of legislation such as S. 2162 and S. 711. We understand the Cabinet Council on Economic Policy also supports changing the status of the FFB and its transactions. But we have not seen the details of their recommendation.

In the fiscal year 1984 Budget, the President proposed that CBOs sold by the Rural Housing Insurance Fund of the Farmers Home Administration be treated as agency debt beginning in 1984. This is a good beginning. However, we believe that further legislation is needed to change the treatment of the remaining CBO sales.

The FFB had done a good job at being a financial go between. However there are problems of how FFB has been used to accomplish off-budget financing for some credit programs. We believe that the problems are not inherently caused by the FFB

but in how some credit transactions are treated in the budget. At the same time, we recognize that while the FFB may not be the direct cause, its off-budget status has added to the credit problems. We continue to believe that decisions to allocate resources among competing activities are efficiently and effectively done when all programs costs are disclosed in budget documents and when control is exercised through the budget process. We would be pleased to work with you to achieve these objectives.

That completes my prepared statement. I would be happy to respond to any questions.

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Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to discuss our views on the operations of and budgeting for the Federal Financing Bank (FFB) and congressional oversight and control of Federal credit programs. As I will point out later in my testimony, our concerns are not directed at the FFB, per se. Instead, they are directed at how transactions involving the Bank and other Government agencies are reflected in the unified budget and how these affect the understanding of Federal credit activities.

GROWTH AND HISTORY OF THE FEDERAL FINANCING BANK

The Federal Financing Bank began operations in 1974. By 1982, its portfolio had grown to about $124 billion. In the most recent years, from 1979 to 1982, the Bank's portfolio has grown an average of $20 billion per year. Thus, almost half of its total holdings have been added since 1979. The FFB held about 18 percent of the total Government portfolio of loans and loan guarantees at the end of fiscal year 1982, up from 12 percent in fiscal year 1979. In fiscal year 1981, FFB's portfolio was the largest of any of the top ten banks in the United States.

Before the FFB was established in 1973, all the borrowing and loan guarantees made by agencies put the U.S. Government in the public securities market 3 out of 5 days. In comparison to Treasury issues, most of these independent agency issues were small in dollar amount and lacked Treasury's firm secondary market. These differences, plus the market's unfamiliarity with specific agencies or unique issues, meant that agencies had to pay an interest rate higher than was paid on comparable Treasury issues, even though both were backed by tne full faith and credit of the U.S. Government. Similarly, loans guaranteed by the full faith and credit of the U.S. Government were financed at higher interest rates than direct Treasury obligations with similar backing. Agencies also incurred additional administrative costs for financing staffs and underwriting expenses.

This prompted the Congress to establish the Federal Financing Bank. According to section 2 of the Federal Financing Act (12 USC 2281), the Bank was established to assure coordination of borrowing programs with the overall economic and fiscal policies of the Government, to reduce the costs of Federal and federally assisted borrowings from the public, and to assure that such borrowings are financed in a way that is least disruptive of private financial markets and institutions.

How the FFB operates

The FFB, an integral unit of the Department of the Treasury, functions as a financial intermediary or go-between. It either lends funds to or purchases the loans of Federal agencies responsible for administering Federal credit programs and to those directly benefiting from Federal credit assistance. The Bank obtains these funds by issuing its own securities.

Section 9 of the act authorizes the FFB to issue in the private markets and have outstanding up to $15 billion of its own securities. FFB is also authorized to borrow from the Secretary of the Treasury without limit, subject to the Treasury's approval. It was initially expected that the FFB would finance most of its activities by selling securities to the public, but since July 1974 all funding has been obtained through the Treasury. Since Treasury borrows to provide funds to the FFB, its borrowings from Treasury are translated into public debt.

Although the FFB is a financial intermediary, it should not be compared to private sector intermediaries because they are not alike: The FFB is a "blind" intermediary. By this I mean that decisions about such things as the use of proceeds are beyond the Bank's control. Neither the FFB nor the Secretary of the Treasury are allowed to make judgments about the purpose of Federal agency programs. Also, the Secretary is prohibited from withholding approval of an agency borrowing transaction for longer than 60 days unless there is a detailed explanation provided. But in no case can approval be withheld for longer than 120 days.

Types of FFB transactions

According to section 6 of the act, the FFB may purchase "any obligation which is issued, sold, or guaranteed by a Federal agency." The FFB engages in three types of transactions. It purchases on- and off-budget agency debt securities. It purchases agency certificates of beneficial ownership or agency assets that are guaranteed by the issuing agency. It also purchases federally guaranteed borrowings of nongovernmental entities. About 78 percent of FFB's $124 billion portfolio in fiscal year 1982 was for CBOs and agency guaranteed loans.

--Purchase of debt securities. Many on- and off-budget agencies have congressional authority to borrow to finance their activities in the same way as the Treasury offers bonds, notes, and bills to finance the deficit. On-budget agency debt accounts for just over 20 percent of the FFB's total portfolio,

and off-budget agency debt accounts for about 1 percent. About half of the agency borrowing from FFB, in turn, is used to fund agency loan programs.

--Purchase of agency assets. The purchase of agency assets is the largest category of FFB holdings and includes certificates of beneficial ownership. These CBOs represent "ownership" of interests in a pool of loans made and still held by a selling agency. These securities are sold by the agency and guaranteed by the Government. When the securities are sold, they are by law treated in the budget as a sale of a loan asset, even though the loans that back CBOs are still held by the administering agency.

One of the largest sellers of CBOs is the Farmers Home Administration, which accounts for 90 percent of FFB's holdings of CBOs. Through its numerous loan programs, this agency has become the single largest user of the FFB, having outstanding CBOs of $54 billion.

--Purchase of guaranteed securities. The last category of FFB holdings is guaranteed securities issued by non-Federal borrowers. Under this arrangement, the FFB lends money directly to a non-Federal enterprise whose obligation to repay the funds is guaranteed by a government agency who has an interest in the activities performed by that enterprise. For example, NASA engaged Western Union Space Communications to build and operate a satellite communications system that NASA eventually leased. Western Union's $786 million project costs were financed by the FFB, with NASA's full guarantee of loan repayment. The FFB may

accepts agencies' 100 percent guarantee of repayment; it assumes no risk in these transactions. Like CBOs, guaranteed loans are off-budget items. Since fiscal year 1980, guaranteed loans have grown from 25.7 percent of FFB's total portfolio to about 31 percent in fiscal year 1982.

In recent years the FFB guaranteed loans have been increasingly used as a source of short term funding. Although net FFB outlays to borrowers have grown from $6.8 billion to $8.7 billion from 1980 to 1982 gross loans made by the FFB have doubled from $10 billion to $20 billion. A large part of the growth in gross loan transactions is due to rapid rollover of borrowings, in some cases every 90 days. For example, while Amtrak's net borrowing from the FFB was increasing from $68.9 million in fiscal year 1980 to $78.8 million in fiscal year 1982, its real borrowing was going from $1.1 billion to $3.2 billion.

In case of guaranteed loan or CBO default, FFB is repaid by the guaranteeing agency. Some agencies, like the Department of Defense, have established reserve funds for this purpose. Since many agencies have made no such arrangements, reimbursements to the FFB are made from appropriated funds or from retained earnings, as in the case of public enterprise operations.

FFB OPERATIONS POSE BUDGETARY PROBLEMS

The FFB has been successful as a debt management and financing tool. As the Congress intended, the FFB operates as an intermediary to coordinate and consolidate agency credit functions, thus saving interest and administrative and under-

writing costs. But the off-budget status of the FFB and the budgetary treatment of its CBO and loan guarantee transactions have caused budget decision problems since the Bank was created.

The FFB credit activities are given off-budget status, which means that outlays by the Bank and all other off-budget agencies (Rural Electrification Administration, Postal Service, U.S. Railway Association, U.S. Synthetic Fuels Corporation, Federal Reserve System, and Strategic Petroleum Reserve) are not counted in the unified budget totals. This practice understates outlay and deficit totals, and these are key points of control in the budget process. Because of the off-budget treatment of FFB operations, the budget deficit was understated by $14.1 billion in fiscal year 1982.

Mr. Chairman, you raised the question of whether it is appropriate for the FFB to have unlimited funding through the Treasury. Since inception, nearly all FFB funds have been obtained from the Treasury, where it is authorized unlimited borrowing. But we do not believe that is the real problem. Nor do we believe the FFB is the appropriate point of control. If FFB access to Treasury funding were limited, the FFB, in turn, would be required to limit agency access to it. That means that the FFB would have to choose among potential borrowers. Thus, the FFB would be put in a policymaking role with respect to the credit budget. That was not part of the original conception of the FFB and would duplicate the existing budget process. If the objective of such a limitation is to control the volume of

Federal credit programs, we believe this should be accomplished by controlling the programs directly through the budget process.

IMPACT OF FEDERAL FINANCING BANK ON CREDIT ACTIVITIES

Turning now to the question of whether the FFB has unduly increased Federal credit activities, I believe it is safe to say that it has not reduced them. And, there are reasons to believe that FFB's existence and, more precisely, its off-budget status, has caused some growth in credit activities that might not otherwise have occurred. It is not possible, however, to be precise about the extent to which this has happened.

For asset sales, and in particular the CBO financing instruments used by the Farmers Home Administration to finance its lending activity, the FFB serves as a captive market for the sale of these securities. Before the FFB was created, Farmers Home had to be concerned with arranging for investment bankers to originate, underwrite, and market its issues. Timing of the sale was an important consideration, and ill-timed issues resulted in unfavorable terms. As I indicated, the FFB was created to eliminate many of these problems and their associated expenses. So, the financing channel provided by the FFB has certainly made it easier for Farmer's Home to fund its lending operations. It is reasonable to assume that this increased ease of financing may have translated into greater level of lending activity.

Furthermore, the off-budget status of the FFB has perpetuated the lack of visibility associated with the use of CBOs as well as all other credit activities that are off-budget in their own right. Were the FFB on-budget and asset sales or fully guaranteed loans still financed through it, they would be recorded as outlays in the budget totals. It is reasonable to assume that the resulting visibility in an era of severe budgetary constraints would have led to greater restraint in the growth of many credit programs now financed by the FFB.

In addition to these considerations, the deepened interest rate subsidies associated with FFB lending for guaranteed loan programs may have stimulated the demand for Federal credit. The FFB makes guaranteed loans to private sector entities at the Treasury borrowing rate plus one-eighth of a point markup. Though fully guaranteed loans funded by private lenders are risk-free, interest rates are still higher than the cost of Treasury borrowing because private borrowing costs are higher and because of tax considerations.

Whether lower interest costs of FFB purchased guaranteed loans has affected credit markets and raised interest rates depends first, on whether their supply under various programs is unconstrained. If it is unconstrained, then the extent to which FFB's activities affect credit availability in commercial markets depends, in part, on whether the programs whose guarantees are purchased by the FFB are intended to reallocate credit in the first place. In certain cases programs do not

reallocate credit. In large measure, they simply subsidize the financing of activities that would be engaged in anyway at prevailing rates by creditworthy borrowers. In other cases, programs assist non-creditworthy borrowers and financial resources are reallocated to borrowers who simply could not obtain credit on reasonable terms. In these cases, the deepened interest rate subsidy associated with FFB financing may stimulate demand and accentuate this resource reallocation. Since we have not carefully studied the loan guarantee programs that the Federal Financing Bank finances to determine whether there are supply constraints or which of the programs are for creditworthy versus non-creditworthy borrowers, and since the relationship between the level of interest subsidy and the demand for Federal credit has little precision, it is very difficult to be any more specific.

If there is an increase in FFB's purchase of loan guarantees to less than creditworthy borrowers, it may be expected to raise the level of interest rates to unassisted borrowers who must compete for a smaller supply of loanable funds. If we assume that private rates of return to unassisted borrowers are higher than those expected by assisted borrowers, then any displacement in the market of creditworthy by non-creditworthy borrowers will tend to lower the average rate of return from the economy's investments. This, in turn, will adversely affect economic growth.

I hasten to add that Federal credit programs are created to achieve purposes other than those that are purely economic. The Rural Electrification Program, for example, was designed to improve the quality of life in rural America. The rate of return achievable by participating public utilities was not an important consideration. Furthermore, the subsidy in a credit program is no different than providing a cash grant of equivalent value to a borrower that is sufficient to induce that person to seek financing on a particular project. So there is nothing unique about credit programs in terms of their reallocation effects--it is really the size of their subsidy, not how it is conveyed. So, if the activities of the Federal Financing Bank have resulted in an expansion of certain types of Federal credit assistance, the crucial question is whether the deepened subsidy to certain classes of borrowers is intended. If it is not, then in these cases, the passthrough of Treasury borrowing costs to guaranteed loan program participants should be discontinued.

The FFB has done a good job at being a financial go-between. However, as I have described, there are problems of how FFB has been used to accomplish off-budget financing for some credit programs. We believe that the problems are not inherently caused by the FFB but in how some credit transactions are treated in the budget. At the same time, we recognize that while the FFB may not be the direct cause, its off-budget status has added to the credit problems. We view these as budget, debt, or credit management problems rather than as FFB problems and plan to address some of these issues in our work.

Just recently we initiated a review of FFB's effect on credit and debt management issues. Specifically, our review will concentrate on

--the extent to which present procedures for using the FFB encourage greater use of off-budget financing than would occur without the FFB;

--whether it would be appropriate to take additional steps to assure that credit extended as a result of FFB financing conforms to reasonable credit management standards;

--debt management issues, including FFB's effect on the maturity structure and cost of Treasury debt; and

--ways in which greater use of the FFB would be advantageous to the Government.

IMPLICATIONS FOR BUDGETARY CONTROL, OVERSIGHT, AND ALLOCATION OF RESOURCES

Just like other assistance programs, Federal credit programs need to be evaluated and need to compete for budgetary resources. When program costs are not fully disclosed during the regular budget process, it is difficult to make sound judgments among competing programs. Current budget procedures for credit programs exclude large amounts of budget resources from agency program levels and from the unified budget totals. This fragments oversight of credit, frustrates the setting of priorities, and undermines the allocation of resources. These procedures allow on-budget agencies to operate at a level of activity that is much higher than is implied by the amount of net outlays recorded for the program. This raises the question of whether

funds are being misallocated to these activities. The Congress allocates budgetary resources through the budget process, starting with setting targets for total budget authority and total outlays and then dividing these targets by major government functional activities in budget resolutions and ending with apropriation acts by budget account. Removing Federal funds from this unified budget reduces its use as a measure of gross Federal activity.

ACTIONS THAT NEED TO BE TAKEN

In recent years, there has been a growing awareness of the budgetary problems created by the FFB's financing of CBOs and guaranteed loans and by the off-budget status of several Federal activities. As a result, there have been proposals from various organizations and individuals to correct the problems. Some recommendations focus on the FFB; others concentrate on the transactions that help create the problems.

There is no simple solution to problems surrounding oversight and control of Federal credit programs, and a number of changes are needed. To be effective, the changes should

--improve the meaning and usefulness of Federal program information and the unified budget totals, including the surplus or deficit figures;

--improve the information, analyses, and procedures for oversight and allocation of resources for Federal credit programs; and

--preserve the effectiveness of the FFB's intermediary operations.

GAO has addressed many of the issues affecting Federal credit programs and has made a number of recommendations.

--We recommended that the FFB be included in the budget. This would improve the usefulness and comprehensiveness of the unified budget totals because FFB budget authority and outlay totals would be included. A problem would still exist because FFB's operations would be recorded in a separate FFB account and not in the appropriation accounts responsible for implementing the credit program. Agencies would still be able to arrange for the FFB to acquire loan assets and to make direct loans guaranteed by the program agency, thus reducing program account totals. We believe that additional changes could be made to correct this problem. First, CBOs should be treated as borrowing by the program agency rather than as a sale of assets. Second, FFB direct loans guaranteed by the program agency should also be treated as agency borrowing from the FFB with the direct loan being included in the program agency's outlays instead of FFB's.

--We recommended that the outlays of revolving funds be reported on a gross basis. For credit programs, this would require showing both gross new lending and loan repayments.

--We recommended that certificates of beneficial ownership be treated as agency borrowing, rather than as the sale of an

asset. By adopting this recommendation, agencies would not be allowed to reduce their outlay totals by selling CBOs. The effects of this change would be the same whether the FFB were on-budget or off-budget.

--Finally, we have long held that systematic congressional review, oversight, and decisionmaking through the budget process is as important for credit programs as for any other type of assistance. Present budget procedures, however, make the allocation of resources to credit programs, at best, a very difficult process. For this reason, we have continued to urge the Congress to formalize budget procedures that will allow, by means of a "credit budget," comprehensive control of credit programs. We are pleased to note the significant steps taken by the Congress along these lines over the last few years.

Actions have been proposed that would go a long way toward establishing better credit controls by seeking to correct some of the shortcomings of the unified budget. Beginning in 1980,the executive branch proposed a credit control system for reviewing and regulating annual credit, both on-budget and off-budget. The system was intended to work through appropriations limitations on annual gross direct loan obligations and guaranteed loan commitments. The Congress has responded by enacting appropriation limitations for most of the program amounts requested by the Administration. However, many programs are exempted from appropriation control, and there are no formal requirements to establish these limitations.

In another effort to bring credit programs within the discipline of the budget process, the Concurrent Resolution on the budget for fiscal years 1981, 1982, and 1983 contained

nonbinding recommendations of targets for total direct loan obligations and total loan guarantee commitments. In fiscal years 1982 and 1983, targets were also established by functional categories. Targets placed on FFB lending were included in the fiscal year 1982 resolution but not in the one for fiscal year 1983. However, a new provision in the fiscal year 1983 budget resolution makes any credit legislation authorizing new direct loan obligations or new guarantee loan commitments subject to a point of order unless the authority is effective only in such amounts as are contained in appropriation acts.

Legislation has been introduced to amend the 1974 Budget Act to establish procedures for setting targets and ceilings within the congressional budget process for direct and guaranteed loans. Other legislation has been introduced to change the status of the FFB and the treatment of CBO sales and FFB originated direct loans. Specifically, you asked for our views on S. 2162, introduced during the last Congress, and S. 711 which was introduced recently. We formally commented on S. 2162, a bill to include FFB amounts in the budget's totals and require that the sale of CBOs and direct loans be treated as borrowings rather than as sales of assets. The objective of S. 711 is similar. Based on our prior work in these areas, we fully support the objectives of legislation such as S. 2162 and S. 711. Changing the status of the FFB and its transactions has also been supported recently by the Cabinet Council on Economic Policy. Details of how the change is to be implemented have not yet been announced.

In the fiscal year 1984 Budget, the President said that he intends to introduce legislation to have the CBOs that are sold by the Rural Housing Insurance Fund of the Farmers Home Administration treated as agency debt beginning in 1984. We believe this action is a good beginning to correct the understatement of agency credit program accounts. However, we believe that further legislation is needed to change the treatment of the remaining CBO sales. For example, in fiscal year 1982, total CBO sales of $12.6 billion were subtracted from agency budget outlays. Of this amount, the Rural Housing Insurance Fund amounted to $5.2 billion. The remaining $7.4 billion in CBO sales were accounted for by the Agriculture Credit Insurance Fund, the Rural Development Insurance Fund, and the Rural Electrification Administration. These should also be treated as borrowing.

We continue to believe that decisions to allocate resources among competing activities are efficiently and effectively done when all programs costs are disclosed in budget documents and when control is exercised through the budget process. We would be pleased to work with you to achieve these objective.

That completes my prepared statement. I would be happy to respond to any questions.

Senator TRIBLE. Mr. Havens, I thank you. We do look forward to working with you in advancing this legislation that will tackle the problem that you have sketched.

What is the timetable for review about which you testified, the review of the Federal Financing Bank's effect on credit and debt management?

Mr. HAVENS. The formal work has been in the planning stage now for several months. We are preparing to go into some more detailed work over the course of the spring. I would expect that we would be in a position to give you some reasonable information on the conclusions we have reached by midsummer.

I would expect our formal report probably will not be issued before the end of the year. We will keep you apprised of the progress.

Senator TRIBLE. We will keep our line of communications open.

FFB OFF-BUDGET STATUS OF ACTIVITY

Is it a fair summary of your testimony and the position of the GAO that the problems associated with the Federal Financing Bank's activities are in the main not due to the existence of the Federal Financing Bank but rather to the off-budget status of much of its activity?

Mr. HAVENS. That is correct. We supported the creation of the FFB in the early 1970's. We continue to support it as a useful intermediary agency.

What we are concerned about is the way it is treated in the budget and the way a number of other transactions involving credit are treated in the budget. They sort of go together as compounding the problems.

Senator TRIBLE. Is it your view, then, that the low visibility of off-budget, direct lending programs has contributed in large part to the very rapid growth of Federal credit over the last decade?

Mr. HAVENS. It is hard to be very precise about the degree of contribution that comes from any one cause.

As Ms. Rivlin testified earlier, I have to share her view as a budgeteer that we are all a lot better off when those are visible.

I find it hard to believe that had these off-budget activities been included in the budget totals and reflected in the estimated deficit, for example, that they would not have gotten more attention and be subject to greater discipline than has been the case for the past decade. So I have to believe that lack of visibility has contributed quite significantly to the greater growth of off-budget credit activities.

Senator TRIBLE. The Congress has been less than successful in limiting the growth of Federal credit activity. This has led recently to the suggestion that the FFB, or perhaps the Office of Management and Budget, should limit Federal credit activities administratively.

I would ask you, can these bodies legally limit FFB-related activities today? Second, should they, or is this properly a function of the Congress and a responsibility that we should confront?

Mr. HAVENS. I am not aware of any special authority that exists in either OMB or FFB to limit its activities or limit the volume of

lending in which it engages. To the extent that Congress considers it appropriate to control the volume of credit activity, I would strongly urge that they do so through their budget process, and we have endorsed, along with Dr. Rivlin, the idea of a formalized credit budget, and we believe that that is the appropriate vehicle for controlling these activities.

I think it would be rather risky to place the power in FFB to control its lending to the agencies because the net effect of that would be to give the FFB the power to control the operation of those agencies themselves.

CREATION OF TITLE X

This is not a role which was originally envisioned for FFB, and problems related to comparable activity on the part of OMB in the early 1970's led to the creation of title X of the Congressional Budget Act, controlling impoundments.

I think that other than something comparable to title X for credit activities where it is not now applicable, such as in the guarantees area, that other power to control the level of activity should be vested in Congress and retained by the Congress.

Senator TRIBLE. Thank you, Mr. Havens.

Senator Hecht.

Senator HECHT. Mr. Chairman, is this our last witness?

Senator TRIBLE. Yes.

Senator HECHT. Nothing at this time.

Senator TRIBLE. Mr. Havens, thank you very much. These have been successful hearings today, and your testimony and that of the other witnesses I think has laid the groundwork for prompt and decisive action by this committee.

We thank you very much and look forward to working with you.

Mr. HAVENS. We do likewise.

Senator TRIBLE. With that, the session is concluded.

[Whereupon, at 11:10 a.m., the subcommittee was adjourned.]